(21)

No. 96-871-CFX
Status: GRANTED

Title: State Oil Company, Petitioner
v.
Barkat U. Khan and Khan & Associates, Inc.

Docketed:
December 2, 1996

Court: United States Court of Appeals for the Seventh Circuit

Counsel for petitioner: Baumgartner,John

Counsel for respondent: DiVincenzo,Anthony S.

Entry	Date	Note	Proceedings and Orders
1	Nov 26 1996	G	Petition for writ of certiorari filed. (Response due January 1, 1997)
3	Jan 2 1997		Brief of respondents Barkat U. Khan and Khan & Associates in opposition filed.
4	Jan 13 1997	X	Reply brief of petitioner State Oil Company filed.
2	Jan 15 1997		DISTRIBUTED. February 14, 1997 (Page 15)
5	Feb 18 1997		Petition GRANTED. Limited to Questions 1 and 2 presented by the petition. SET FOR ARGUMENT October 7, 1997. **********
6	Apr 3 1997		Joint appendix filed.
7	Apr 3 1997		Brief of petitioner State Oil Company filed.
8	Apr 3 1997	G	Motion of Association of the Bar of the City of New York for leave to file a brief as amicus curiae filed.
9	Apr 3 1997	G	Motion of Business Roundtable for leave to file a brief as amicus curiae filed.
24	Apr 3 1997		Motion of the Business Roundtable for leave to file a brief as amicus curiae filed.
10	Apr 4 1997		Brief amici curiae of American Automobile Manufacturers Association, et al. filed.
11	Apr 4 1997		Brief amicus curiae of American Petroleum Insitute filed.
12	Apr 4 1997		Brief amicus curiae of National Association of Manufacturers filed.
13	Apr 4 1997		Brief amicus curiae of National Beer Wholesalers Association, Inc. filed.
14	Apr 4 1997		Brief amici curiae of Newspaper Association of America, et al. filed.
15	Apr 4 1997		Brief amicus curiae of Coalition for Fair Consumer Pricing filed.
16	Apr 4 1997		Brief amici curiae of United States and the Federal Trade Commission filed.
23	Apr 4 1997		Motion of the Association of the Bar of the City of New York for leave to file a brief as amicus curiae filed.
19	May 2 1997		Brief amici curiae of Thirty-Three States and the Territory of Guam filed.
20	May 2 1997		Brief amicus curiae of National Automobile Dealers Association filed.
18	May 5 1997		Brief of respondents Barkat U. Khan and Khan & Associates filed.
21	May 5 1997		Brief amicus curiae of Service Station Dealers of America filed.
22	May 5 1997		Brief amici curiae of Minnesota Service Station and

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No. 96-871-CFX

Entry	Date	Note	Proceedings and Orders
			Covenience Store Assn., et al. filed.
25	May 16 1997	G	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
26	May 27 1997		Motion of Association of the Bar of the City of New York for leave to file a brief as amicus curiae GRANTED.
27	May 27 1997		Motion of Business Roundtable for leave to file a brief as amicus curiae GRANTED.
28	May 27 1997		Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
29	Jun 5 1997		Reply brief of petitioner State Oil Company filed.
30	Jun 20 1997	G	Motion of New York, et al. for leave to participate in oral argument as amici curiae and for divided argument filed.
31	Jun 27 1997		Motion of New York, et al. for leave to participate in oral argument as amici curiae and for divided argument GRANTED.
32	Aug 15 1997		CIRCULATED.
33	Aug 19 1997		Record filed.
		*	Partial record proceedings United States Court of Appeals for the Seventh Circuit.
34	Oct 3 1997		Record filed.
		*	Original record proceedings United States District Court for the Northern District of Illinois.

Supreme Court, U.S.
FILED

(1)

96 871 NOV 26 1996

OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN and KHAN & ASSOCIATES, an Illinois Corporation,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Did the court below err in holding that a gasoline dealer, who was limited to a margin of 3.25 cents per gallon, was entitled to recover damages under §4 of the Clayton Act, for losses which he claimed from his inability to increase his profit by increasing his price to consumers?

2. Did the court below err in holding that an agreement between a supplier, who was also the landlord of the property on which the business was conducted, and a dealer, under which the dealer's margin or markup was limited was a *per se* violation of the Sherman Act?

3. Did the court below err, in an appeal from a summary judgment, in considering an expert witness report in which the expert had determined that the dealer could have raised his prices because another party operating the gasoline station during a portion of the next year had raised his prices?

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PETITION FOR WRIT OF CERTIORARI

State Oil Company respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this proceeding on August 29, 1996.

OPINIONS BELOW

The decision of the United States Court of Appeals for the Seventh Circuit is reported at 93 F.3d 1358. The underlying judgment of the trial court is reported at 907 F.Supp. 1202. The opinions of the District Court and the Court of Appeals are reproduced in the Appendix to this petition.

JURISDICTION

On August 29, 1996, the United States Court of Appeals for the Seventh Circuit issued its decision reversing the judgment entered by the trial court. Jurisdiction in this Court is based on 28 U.S.C. §1254(1).

STATUTES INVOLVED IN THIS CASE

§1 of the Sherman Act (15 U.S.C. §1)

Contracts, Combinations and Conspiracies in Restraint of Trade

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed

guilty of a felony and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§4(a) of the Clayton Act (15 U.S.C. §15[a])

Actions for Damages

(a) Damages; Prejudgment Interest

Except as provided in subsection (b), any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. The court may award under this section, pursuant to a motion by such person promptly made, simple interest on actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein, if the court finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this section for any period is just in the circumstances, the court shall consider only–

(1) whether such person or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in merit as to show that such party or representative acted intentionally for delay, or otherwise acted in bad faith;

(2) whether, in the course of the action involved, such person or the opposing party, or either party's representative, violated any applicable rule, statute, or court

order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings; and

(3) whether such person or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof.

STATEMENT OF THE CASE

Defendant State Oil Company was the owner of a parcel of real estate improved with a gasoline station/convenience store. It was also a distributor of gasoline for major oil companies. State Oil Company entered into an agreement with the plaintiff Khan under which it leased the gasoline station/convenience store to him, and also agreed to sell him gasoline for resale to the public. That agreement provided that State Oil Company was to set a suggested retail price for each brand of gasoline, and would sell the gasoline to Khan for 3.25 cents per gallon under that suggested price. The agreement did not require Khan to sell at the suggested price. However, if he raised his price above the suggested price, he was obligated to pay all excess to State Oil.

After Khan had operated the station for a year, a receiver was appointed by a state court. That receiver operated the station for five months. Khan claimed that the receiver had charged a margin in excess of 3.25 cents per gallon during his term of operation, and that this demonstrated that he had lost profits, because he was influenced by the contract provision not to raise his price.

The District Court for the Northern District of Illinois, granted summary judgment in favor of State Oil, holding that there was no showing by plaintiff that the provision

complained of contained any anticompetitive aspect, that the damages claimed by plaintiff were not antitrust damages that there was no evidence that plaintiff actually suffered any injury, and that the rule of reason should be employed in any analysis. The Court of Appeals for the Seventh Circuit reversed, remanding the case to the District Court.

REASONS FOR ALLOWANCE OF THE WRIT

This case presents important questions of federal law which have not been, but should be, settled by this Court:

1. Did the court below err in holding that a gasoline dealer, who was limited to a margin of 3.25 cents per gallon, was entitled to recover damages under §4 of the Clayton Act, for losses which he claimed from his inability to increase his profit by increasing his price to consumers?

The lower court based its decision primarily upon *Albrecht v. Herald Company,* (1968) 390 U.S. 145, 88 S.Ct. 869. The court agreed with State Oil that the damages claimed by Khan did not constitute antitrust damages, and that post *Albrecht* decisions requiring evidence of antitrust injury portend the doom of *Albrecht* (p. 8) It was of the opinion, however, that it was obligated under existing law to reverse the trial court on this question.

This Court in post *Albrecht* decisions has held that a private party bringing suit under §4 of the Clayton Act must establish that the injury which it has suffered is of the type which the antitrust laws were designed to

prevent. To date that principle has been applied only in actions brought by competitors of the defendant. Whether the requirement of antitrust damages would apply in a private antitrust action between a single supplier and a single dealer is an important question of federal law which has not been, but should be, settled by this Court. Analysis of this question also involves questions concerning the continuing viability of *Albrecht v. Herald Company,* supra, and the application of *per se* liability in a situation which presents no obvious threat to competition. This case clearly presents each of these questions. The case also presents a question concerning the standards for acceptance of expert testimony.

In *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.,* (1977) 429 U.S. 477, 97 S.Ct. 690, 60 L.Ed.2d 701, and in *Atlantic Richfield Co. v. USA Petroleum Co.,* (1990) 495 U.S. 328, 110 S.Ct. 1884, at 1892, 109 L.Ed.2d 333, this Court discussed the requirement that a private party bringing suit under §4 of the Clayton Act, must not only prove an injury resulting from the actions of the defendant, but must also prove that this injury was of a type the antitrust laws were intended to prevent. Both of these decisions post-dated *Albrecht*. Plaintiff in each of those cases was a competitor who was claiming injury, and each contains language which infers that the ruling applies only to a suit by a competitor. The injury claimed in *Atlantic Richfield* was a loss of sales because of a reduction in a competitor's prices. The injury claimed in this case is a loss of profits from an inability to raise prices. This suit was brought by a dealer rather than a competitor. In *Caribe BMW, Inc. v. Bayerische Motoren Werk Aktiengesellschaft*, 19 F.3d 745 (1994), the First Circuit distinguished *Atlantic Richfield Co. v. USA*

Petroleum Co., because the plaintiff was a dealer, not a competitor. The difference presents no economic or legal distinction, because if defendant's actions would not injure competition in a suit by a competitor, they would not injure competition in a suit brought by Khan.

As the lower court stated on page 8, it did not believe that the damages claimed by Khan were antitrust damages. It refused, however, to affirm the trial court on that basis, both because it felt bound by *Albrecht*, and because even though *Albrecht* does not address the question of antitrust damages, the court was unable to state that this Court might not have a broader concept of antitrust damages than that proposed by State Oil.

Injury, "although causally related to an antitrust violation, nevertheless will not qualify as 'antitrust injury' unless it is attributable to an anti-competitive aspect of the practice under scrutiny, 'since [i]t is inimical to [the antitrust] laws to award damages' for losses stemming from continued competition." *Atlantic Richfield Co. v. USA Petroleum Co.*, 110 S.Ct. at 1899. The damages claimed by Khan in this case resulted totally from his inability to charge more to consumers. Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. *Atlantic Richfield Co. v. USA Petroleum Co.*, 110 S.Ct., at 1892. Hence, as the lower court noted (p. 11), they cannot logically give rise to antitrust injury unless antitrust injury arises from interference with the freedom of a dealer as well as from anticompetitive activity.

If the price which plaintiff could charge without incurring any obligation to pay the excess to defendant was at or above what competing stations were charging, he would have been unable to raise his price, and he suffered no injury. If that price was below market, to the extent that he could have raised his price and still maintained his sales, he may have suffered an injury. However, that injury would not be of a type which the antitrust laws were intended to prevent.

2. Did the court below err in holding that an agreement between a supplier, who was also the landlord of the property on which the business was conducted, and a dealer, under which the dealer's margin or markup was limited was a per se violation of the Sherman Act?

The criticism which the decision in *Albrecht v. Herald Company*, supra, has received from antitrust scholars and from the lower courts is an indication that the decision should be reconsidered.[1] The decision of the lower court in this case reads as a petition to this Court to reconsider *Albrecht*. As the lower court pointed out on page 9 of its opinion, the decision in *Albrecht* is inconsistent with the later decisions by this Court. It is also contrary to all of the principles announced by this Court in *Business Electronics v. Sharp Electronics*, (1988) 485 U.S. 717.

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[1] See, for example, Easterbrook, *Maximum Price Fixing*, 48 U.Chi.L.Rev. 886 (1981). Blair and Harrison, *Rethinking Antitrust Injury*, 42 Vand. L. Rev. 1539 (1989), 8 Phillip E. Areeda, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶¶ 1635-38 (1989), Blair, *The Ghost of Albrecht*, 40 The Antitrust Bulletin 205 (1995).

In *Business Electronics v. Sharp*, supra, this Court explained the basis upon which *per se* liability should be applied. It is unlikely, in light of the principles discussed in that decision, that *Albrecht v. Herald Company* would be decided in the same manner were it to come before this Court today, as a matter of first impression. Commencing at page 723, the Court explained what factors should be considered in deciding whether a *per se* analysis or the rule of reason should be applied in any particular case.

> "Certain categories of agreements, however, have been held to be per se illegal, dispensing with the need for case-by-case evaluation. We have said that per se rules are appropriate only for 'conduct that is manifestly anti-competitive,' id. (*Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36), at 50, 97 S.Ct., at 2557, that is, conduct 'that would always or almost always tend to restrict competition and decrease output,' *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-290, 105 S.Ct. 2613, 2617, 86 L.Ed.2d 202 (1985)." "[W]e have been slow . . . to extend per se analysis to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious." "Per se rules are invoked when surrounding circumstances make the likelihood of anti-competitive conduct so great as to render unjustified further examination of the challenged conduct." "agreements are per se illegal only if their "nature and necessary effect are so plainly anti-competitive that no elaborate study of the industry is needed to establish their illegality."

Vertical maximum price fixing is not manifestly anti-competitive and would, under many circumstances, tend to increase competition.

The antitrust laws have been presented in terms of two distinct social or economic objectives. In the price fixing cases, the objective of ensuring the freedom of the individual merchant to make, without restraint, his own market decisions has been given prominence. The trial court in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 at 40, 53 L.Ed.2d 568 at 574, 97 S.Ct. 2549 rejected the defendant's proffered instruction that a location restriction was illegal only if it restrained competition in favor of an instruction that a location restriction constituted a per se violation of the antitrust laws.[2] This Court held the rule of reason should apply even though that restriction also related to the freedom of action of the dealer. In more recent decisions, such as *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, and *Business Electronics v. Sharp Electronics*, supra, prominence is given to competition and the benefits which competition presents to the ultimate consumer, rather than on common law principles concerning restraints on alienation. Vertical restraints which limit the area in which a dealer may sell, certainly restrict the freedom of the dealer as much as a limitation on the price at which it can sell. The prevention of anti-competitive behavior is the primary concern of the antitrust laws, not the elimination of restraints on alienation. *Business Electronics v. Sharp Electronics*, (1988) 485 U.S. at 726.

This case specifically presents that distinction. The agreement between State Oil and Khan limits Khan's

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[2] See also the reference to *United States v. Arnold, Schwinn & Co*, 388 U.S. 365, 18 L.Ed.2d 1249, 87 S.Ct. 1856 (1967) at 433 U.S. 45 and reference to a portion of the dissent below contained in footnote 21 at 433 U.S. 53.

markup on gasoline which he purchases from State Oil. Such an agreement affects the ability of Khan to maximize his own profit, by increasing the price of gasoline to the public at those times when competitive conditions would permit such an increase. There is no contention that the agreement would affect any competitor of Khan, other than possibly forcing that competitor to also reduce his price to the public. The agreement cannot constitute a violation, as such, unless freedom from restraints on alienation is still regarded as being one of the functions of the antitrust laws.

This Court recognized in *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 110 S.Ct. 1884 at 1894, footnote 13 that it is possible for vertical maximum price fixing to have procompetitive effects in certain circumstances. The statement referred to the situation created by exclusive dealerships, and was limited to interbrand competition. However, neither of these limitations need necessarily be applied. Not only can a limitation on pricing have competitive aspects in situations which do not involve exclusive dealerships, but some brands are sold by multiple distributors, who compete with one another as well as with distributors from other firms.

If a manufacturer or supplier is able to limit the prices charged by the retailers it supplies, it reduces the supplier's incentive to operate its own retail outlets, and enhances the supplier's incentive to reduce its own margin in order to increase sales to the consumer. There is normally a limited total markup possible between the manufacturer and the customer. The supplier can increase its profit either by increasing the share of that markup which it takes, or by increasing the sales of the product. The most obvious means of increasing sales is

to reduce the price. However, if the retailer is able to use that reduction to enhance its own profit, leaving the price at the same level, then there is no incentive to the supplier to reduce its price. This is the essence of competition.

This Court has already recognized that some types of vertical restraints, such as limitations on the territory in which a dealer can sell are not necessarily anticompetitive, and may actually have a competitive function in some situations. However, because of prior authority, it has refused to extend that analysis to restraints which specifically affect prices. It is time to consider the possibility that such a distinction is artificial. This case presents the perfect vehicle for such a comparison.

In this particular case, the trial court examined the facts, determined that the agreement between plaintiff and defendant did not impose an unreasonable restraint on competition, and granted summary judgment in favor of the defendant. The Court of Appeals agreed that absent *per se* liability, the trial court would be correct. However, that court reversed, holding that it was obligated to find *per se* liability. The effect of this ruling is that the defendant is conclusively presumed to have engaged in an activity which is in violation of §1 of the Sherman Act, even though the circumstances presented no aspect of any restraint on competition. The characterization of the agreement automatically entitles the plaintiff, who has made no claim of any anticompetitive effect, to treble damages and to payment of its attorney's fees. Formalistic characterization is part of what this Court rejected in *Business Electronics*, supra.

Even if this were an aberration in which a unique circumstance created an unjust result from an otherwise

valuable rule of law, there should be some means of sorting out the blatantly inapplicable situation. There are possible stopping points between forcing an injured plaintiff to go the expense of proof under the rule of reason, and placing an inappropriate defendant in a position in which he is not permitted to defend himself. In situations such as this one, involving a single plaintiff and a single defendant, operating in a massive market, the defendant could be permitted to prove that the purpose and effect were competitive, not anticompetitive. In the alternative, the plaintiff could be required to establish at least some possibility of anticompetitive effect. Expense would be reduced if this determination were made by the court as a preliminary matter. For example in this particular case, defendant could be permitted to establish its relative market share, or its competitive position in a market containing competitors such as Amoco or Shell. This would be neither time consuming nor expensive, and would limit *per se* liability to those situations in which it is appropriate. As the trial court stated on page 14 of its ruling, "Courts must not trivialize the power of the Sherman Act by bestowing an aura of federal antitrust significance upon minor business disputes."

This is not a situation involving a rule of law which has an accepted and recognized value overriding specific inapplicable situations. The rule which was applied has been routinely and universally criticized from its inception. This case squarely presents questions concerning the application of *per se* liability, and of the continuing viability of the decision in *Albrecht v. Herald Co.*, either *in toto* or in the manner of its application to circumstances which vary from those presented in that case.

3. Did the court below err, in an appeal from a summary judgment, in considering an expert witness report in which the expert had determined that the dealer could have raised his prices because another party operating the same gasoline station during a portion of the next year had raised his prices?

In an attempt to establish that he had suffered an injury, Khan presented the report of an expert who expressed an opinion that Khan had lost potential profits from sales at increased prices. As the lower court noted (p. 12), the expert obtained the financial records of a receiver who had operated the station during five months of the year after Khan's operation of the station. The expert determined from those figures that the receiver had realized more than the 3.25 cents per gallon which had been permitted to Khan. The expert determined from this that if Khan had not been limited, he also could have earned more than 3.25 cents per gallon. One of State Oil's objections to that report was that no consideration was given to comparative conditions in the area during the two years. The fact that the receiver was able to sell at a higher price is not evidence that Khan would have been able to sell at a higher price the year before. As both the trial judge and State Oil pointed out, the report was based totally on *post hoc ergo propter hoc*. The trial judge refused to accept this report, in part because it was based on the unsupported assumption that the experience of the receiver was relevant to the experience of Khan during the prior year. See pages 14, 15 and 16 of ruling. The Court of Appeals reversed, stating that the report was sufficiently plausible to defeat summary judgment.

The Court of Appeals (p. 13) analyzed the question in terms of whether the report was generated by the methods which the witness would use in his normal academic or professional work, which is to say in work undertaken without reference to or expectation of possible use in litigation. The Court of Appeals went on to state that neither the district judge nor State Oil identified any basis for supposing that the report flunked this test. The expert explained the method which he used to arrive at his conclusion that the receiver had earned a margin in excess of 3.25 cents per gallon. That, however, was not the question requiring expertise. On the grounds for his assumption that the receiver's experience provided a model upon which to gauge the experience of Khan, the expert provided no explanation.

No evidence was presented to establish that an economist wishing to determine the price which a party could have charged during a particular period of time would reasonably rely upon data concerning activities at a subsequent time. The burden of establishing the validity of a questioned report would normally be on the party presenting that report.

As this Court stated in *Daubert v. Merrell Dow Pharmaceuticals, Inc.* 113 S.Ct. 2786, at 2795, the trial judge must ensure that any and all scientific testimony or evidence admitted is not only relevant, but reliable. If the trial judge concludes that the scintilla of evidence supporting a position is insufficient to allow a reasonable juror to conclude that the position more likely than not is true, it remains free to grant summary judgment. A report of this type, based entirely on hearsay should be admitted only if the facts or data are "of a type reasonably relied upon by experts in the particular field in

forming opinions or inferences upon the subject." *Daubert*, supra at 2798. The primary responsibility of the trial judge, as explained in *Daubert*, is to ensure that reliable and scientifically presentable methods and theories have been used. The expert in this case provided nothing but a bottom line, with absolutely no explanation of how he got from the bottom line to the ultimate question.

CONCLUSION

As pointed out in the concurring opinion in the lower court (p. 16), that court employed a rigorous application of the rules of stare decisis and precedent. This was a rigorous application of principles which have been regularly criticized, applied to a set of facts presenting serious distinguishing characteristics. The principles applied in this case affect the marketing methods utilized (or not utilized) in the American business community. These principles should be reconsidered by the Court at this time.

Respectfully submitted,

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APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 96-1309

BARKAT U. KHAN and KHAN & ASSOCIATES, INC.,

Plaintiffs-Appellants,

v.

STATE OIL COMPANY,

Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 94 C 35—Charles R. Norgle, Sr., *Judge.*

ARGUED JUNE 7, 1996—DECIDED AUGUST 29, 1996

Before POSNER, *Chief Judge*, and FLAUM and RIPPLE, *Circuit Judges.*

POSNER, *Chief Judge.* The plaintiffs (collectively "Khan") operated a gas station in DuPage County, Illinois, under a contract with State Oil Company, a distributor of gasoline and related products. The contract provided for the lease of the station (which State Oil owned), and the supply of gasoline and ancillary products for resale, to Khan. Mr. Khan was the actual signatory of the contract, rather than his corporation, which operated the station, so it does not appear that he is complaining about a merely derivative injury to himself, in which event he would not be a proper party. *Hammes v. AAMCO Transmissions, Inc.*, 33 F.3d 774, 777 (7th Cir. 1994).

State Oil terminated the contract because Khan failed to pay the agreed-upon rent for the station. The termination precipitated this suit, which, so far as relevant to the appeal, charges price fixing in violation of section 1 of the Sherman Act, 15 U.S.C. § 1, and breach of contract under the common law of Illinois. The district judge granted summary judgment for the defendant on both claims. He ruled that the legality under the Sherman Act of the alleged price fixing was to be tested by the rule of reason rather than by the per se rule, that the plaintiff had presented no evidence on essential elements of a rule of reason case (such as market power), that the study conducted by the plaintiffs' economic expert was inadmissible, and that without the study the plaintiffs could not even prove injury.

The contract between State Oil and Khan provided that State Oil would establish a suggested retail price for the gasoline (which was sold under the brand name "Union 76") and would sell the gasoline to Khan for 3.25 cents less than that price. If Khan believed the price was too high he could ask State Oil to lower it and if State Oil complied Khan would be entitled to purchase the gasoline from State Oil at the same margin, that is, at the new price minus 3.25 cents. If State Oil refused to reduce the suggested retail price Khan could still charge a lower price, but his margin would be smaller because he would not be getting a lower price from State Oil. If Khan believed the suggested retail price was too low he could ask State Oil to raise it, thus preserving his margin; but if State Oil refused and Khan went ahead and raised his price anyway, the contract required Khan to rebate the difference between his new price and the suggested price times the number of gallons sold at the new price. The contract thus required Khan to rebate the entire profit from raising his price without his supplier's permission above the retail price suggested by the supplier.

The provision concerning the charging by Khan of a price below the suggested retail price neither is price fixing nor is germane to the price-fixing charge. A supplier is under no obligation to lower his price to his customer just because the customer wants to resell the supplier's product for less than the supplier has suggested without sacrificing any of his profit margin. The contract in this case merely disclaims any such unusual obligation, and since the obligation has no basis in antitrust law the disclaimer has no antitrust significance either.

State Oil also denies that the provision in the contract pertaining to Khan's charging a price above the suggested retail price is a form of price fixing. It points out that Khan was free to charge as high a price as he wishes. This is true in the sense that it would not have been a breach of contract for Khan to raise his price. But the contract made it worthless for him to do so; and, realistically, this was just an alternative sanction to termination, and probably an equally effective one. Generally when a seller raises his price, his volume falls; and if his profit on each unit sold is frozen, the effect of his raising his price will be that he loses revenue: he will sell fewer units, at the same profit per unit. The contract, incidentally, required Khan to buy all his gasoline from State Oil; so he could not merely switch to another brand if he wanted to charge a higher price.

Practices that have the same effect are not always treated the same in law. More precisely, two practices that have one effect in common may differ in their other effects. A merger between competitors and a price-fixing agreement between competitors has the same effect in extinguishing price competition between the parties, but the merger is more likely to produce offsetting cost savings and it is therefore treated more leniently by the antitrust laws. So the fact that State Oil's rebate scheme was as effective in deterring Khan from raising his price as a threat to terminate his lease would have been does not dictate that the two practices be treated identically under the antitrust laws. But State Oil has not identified any other relevant difference between the two methods of preventing a dealer from charging more than the sug-

gested retail price. The purely formal character of the distinction that it urges can be seen by imagining that the contract had forbidden Khan to exceed the suggested retail price and had provided that if he violated the prohibition the sanction would be for him to remit any resulting profit to State Oil. There is no practical difference between that form of words and permitting Khan to sell at a higher price but providing that if he does so the profit belongs to State Oil.

So State Oil engaged in maximum price fixing; the next question is whether this practice is illegal per se, meaning that all the plaintiff need prove to prevail is that the defendant engaged in the practice; investigation of its actual economic effects is pretermitted. E.g., *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988); *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 342-44 (1982). Challenged practices that do not fall within any of the per se categories are subject to the broader-ranging inquiry into effect and motives that goes by the name of the "rule of reason" and that requires the plaintiff to prove that the defendant's conduct actually (or with a high likelihood) reduced competition. *Id.* at 343; *Business Electronics Corp. v. Sharp Electronics Corp.*, *supra*, 485 U.S. at 723. Price fixing has long been illegal per se. In its usual and most pernicious form, the term refers to an agreement or conspiracy between competing firms to fix a minimum price for their product. By a modest extension it refers also to an agreement between competitors to fix either a minimum or a maximum price for the resale of their product by their dealers. See *Arizona v. Maricopa County Medical Society*, *supra*, 457 U.S. at 348; *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951). Why might competitors fix a minimum resale price? In order to make it more difficult for any of them to engage in undetected violations of their agreement to fix their own (that is, the wholesale) prices; a supplier who observed that he was losing sales because his competitor's dealers were selling the competitor's product at a low price would know that the competitor was failing to enforce the price-fixing agreement. Pauline M. Ippolito & Thomas R. Overstreet, Jr., "Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works," 39 *J. Law & Econ.* 285, 293-94 (1996). Why might competitors fix a maximum resale price? The difference between what a supplier charges his dealer and what the dealer charges the ultimate customer is, functionally, compensation to the dealer for performing the resale service; so by agreeing on the resale prices of their goods competing sellers can reduce their dealers' margin below the competitive price for the dealers' service. This is a form of monopsony pricing, which is analytically the same as monopoly or cartel pricing and so treated by the law. E.g., *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, 334 U.S. 219 (1948).

The questionable next step (logically, not chronologically, next) in the evolution of antitrust law was to affix the per se label to contracts in which a single supplier, not acting in concert with any of its competitors, fixed its dealers' retail prices. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). Here the economic difference between fixing a minimum resale price and fixing a maximum resale price becomes more pronounced, although most economists believe that neither form of price fixing is pernicious when the supplier is neither the cat's paw of colluding distributors nor acting in concert with his competitors. A supplier acting unilaterally might fix a minimum resale price in order to induce his dealers to furnish valuable point-of-sale services (trained salesmen, clean restrooms—whatever) to customers, which they could not afford to do without a guaranteed margin to cover the costs of the services, because the customers would use the services provided by the full-service dealers but then purchase the product from a competing dealer who could sell the product at a discount because he had not borne the expense of providing the services. Lester G. Telser, "Why Should Manufacturers Want Fair Trade?"

3 *J. Law & Econ.* 86 (1962); Ippolito & Overstreet, *supra*, 39 *J. Law & Econ.* at 294 (summarizing this and other theories of benign resale price maintenance).

As for maximum resale price fixing, unless the supplier is a monopsonist he cannot squeeze his dealers' margins below a competitive level; the attempt to do so would just drive the dealers into the arms of a competing supplier. A supplier might, however, fix a maximum resale price in order to prevent his dealers from exploiting a monopoly position. We do not know anything about the competitive environment in which Khan and State Oil operate—which is why the district judge was right to conclude that if the rule of reason is applicable, Khan loses. But suppose that State Oil, perhaps to encourage the dealer services that we mentioned, has spaced its dealers sufficiently far apart to limit competition among them (or even given each of them an exclusive territory); and suppose further that Union 76 is a sufficiently distinctive and popular brand to give the dealers in it at least a modicum of monopoly power. Then State Oil might want to place a ceiling on the dealers' resale prices in order to prevent them from exploiting that monopoly power fully. It would do this not out of disinterested malice, but in its commercial self-interest. The higher the price at which gasoline is resold, the smaller the volume sold, and so the lower the profit to the supplier if the higher profit per gallon at the higher price is being snared by the dealer.

Despite these points, the Supreme Court has thus far refused to reexamine the cases in which it has held that resale price fixing is illegal per se regardless of the competitive position of the price fixer or whether the price fixed is a floor or a ceiling. The key precedent so far as the present case is concerned is *Albrecht v. Herald Company*, 390 U.S. 145 (1968), a damages suit like this where the Court held over a vigorous dissent that the action of a newspaper publisher in fixing a ceiling at which its distributors could resell the newspaper to the public was illegal per se. State Oil seeks to distinguish *Albrecht* by pointing out that the initiative for the newspaper to take

action against the plaintiff distributor had come from another distributor, giving the scheme a "horizontal" flavor. True, but this was not a factor on which the Court relied. It stated its holding broadly: maximum price fixing is illegal per se even if entirely "vertical," that is, even if the only parties in the picture are a single supplier and a single dealer, as in this case. The Court explicitly rejected the view that "contracts between a single supplier and his many dealers to fix maximum resale prices would not violate the Sherman Act." *Id.* at 152 n. 8. The only use the Court made of the involvement of the other distributor was to show that it was not a case in which the supplier, as permitted by the *Colgate* doctrine (see below), had merely cut off a dealer for failing to adhere to a suggested price. See *id.* at 149-50. It is not cricket to distinguish a precedent by pointing to a fact mentioned by the court in the previous opinion but clearly given no weight by it. Otherwise no precedents would have any force, for no two cases are exactly alike.

State Oil points out that a supplier has the right to suggest a retail price and terminate a dealer who does not adhere to it. True, *United States v. Colgate & Co.*, 250 U.S. 300 (1919), but irrelevant. In such a case there is no agreement between the parties and so no basis for invoking section 1 of the Sherman Act, which is limited to contracts, combinations, and conspiracies, all of which involve an element of agreement. There was an explicit agreement that Khan could not make money if he sold above the suggested retail price. Had he raised its price above that level, State Oil would have had a contractual right to a rebate.

State Oil's main argument is that *Albrecht* is no longer the view of the Supreme Court. (That argument was squarely rejected in *Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiensgesellschaft*, 19 F.3d 745, 752-54 (1st Cir. 1994), so if we accepted State Oil's argument we would be creating a circuit split.) State Oil relies on a line of cases decided after *Albrecht* in which the Court established the concept of "antitrust injury." There is no right

to maintain a suit under the antitrust laws unless the defendant's conduct has impaired the kind of interest that the antitrust laws were intended to protect. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977). And there is no such interest in the maintenance of a monopoly price. If typically and here a resale price ceiling imposed by a seller merely prevents his dealers from reaping monopoly profits, the injury to the dealers from the ceiling—the loss, that is, of monopoly profits—will not support an antitrust suit. The requirement of proving antitrust injury is not waived in per se cases. In *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990), the Supreme Court held that a competitor of dealers prevented by their suppliers from raising their prices could not complain that the restriction was preventing him from raising his own prices.

We have considerable sympathy with the argument that *Albrecht* is inconsistent with the cases that establish the requirement of proving antitrust injury. In fact, we think the argument is right and that it may well portend the doom of *Albrecht*. In *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698, 706-07 (7th Cir. 1984), we said we regarded the continued validity of *Albrecht* as an open question, albeit for a different reason: that after *Albrecht* the Supreme Court had (reversing its previous position) recognized that exclusive dealer territories may be procompetitive. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). As we pointed out earlier in this opinion, and as one of the dissenting opinions in *Albrecht* had pointed out as well, 390 U.S. at 169, a price ceiling is a natural and procompetitive incident to a scheme of territorial exclusivity. The majority opinion in *Albrecht* had rejected this argument on the ground that price fixing cannot be "justified because it blunts the pernicious consequences of another distribution practice," 390 U.S. at 154, namely exclusive territories. We now know that the consequences of that other practice are not (not generally, at any rate) pernicious. So another prop beneath *Albrecht* has been knocked away, although State Oil does not make the argument from *Sylvania*, maybe because it does not grant its dealers exclusive territories (the record is silent on the matter).

Yet despite all its infirmities, its increasingly wobbly, moth-eaten foundations (see 8 Phillip E. Areeda, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶¶ 1635-38 (1989)), *Albrecht* has not been *expressly* overruled (or, what would amount to the same thing, a later case, conceded to be indistinguishable, has not been expressly overruled). And the Supreme Court has told the lower federal courts, in increasingly emphatic, even strident, terms, not to anticipate an overruling of a decision by the Court; we are to leave the overruling to the Court itself. *Thurston Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533, 535 (1983) (per curiam); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989); *id.* at 486 (dissenting opinion) ("indefensible brand of judicial activism"); see also *Olson v. Paine, Webber, Jackson & Curtis, Inc.*, 806 F.2d 731, 734, 741-42 (7th Cir. 1986). *Albrecht* was unsound when decided, and is inconsistent with later decisions by the Supreme Court. It should be overruled. Someday, we expect, it will be. The Supreme Court in the *Atlantic Richfield* case was willing to assume only "*arguendo*" that *Albrecht* had been correctly decided, 495 U.S. at 335 n. 5, and it cited at length the critical academic commentary on the case. *Id.* at 343 n. 13. And in *Arizona v. Maricopa County Medical Society*, *supra*, the Court, while reaffirming the per se rule against *horizontal* maximum price fixing, noted that *Kiefer-Stewart*, unlike *Albrecht*, had been a case of horizontal maximum price fixing and that "horizontal restraints are generally less defensible than vertical restraints," 457 U.S., at 348 n. 18, though elsewhere the opinion quotes at length from *Albrecht*, and with apparent approval, a denunciation of maximum price fixing not limited to the horizontal variety. *Id.* at 347.

But all this is an aside. We have been told by our judicial superiors not to read the sibylline leaves of the *U.S. Reports* for prophetic clues to overruling. It is not our

place to overrule *Albrecht*; and *Albrecht* cannot fairly be distinguished from this case.

It might be distinguishable if there were a class of cases in which maximum price fixing, though wholly vertical, wholly unilateral, did cause antitrust injury, even if *Albrecht* and the present case were not members of that class. Then, while *Albrecht* itself might be decided differently today, its principle that such price fixing is illegal per se would have some domain of application. In that event affirmance here would construe *Albrecht* narrowly but not abrogate it. But State Oil is not able to identify any cases, real or hypothetical, in which the practice condemned in *Albrecht* could cause an injury to the interests protected by antitrust law. If proof of antitrust injury is required in cases involving the sort of price fixing involved in *Albrecht*, no such case could be brought, whether by a private plaintiff or by the Department of Justice or the Federal Trade Commission.

More to the point, the Supreme Court's conception of antitrust injury may be broader than State Oil's. The Court has never retreated from the proposition that vertical minimum price fixing (resale price maintenance) is illegal per se. See, e.g., *Business Electronics Corp. v. Sharp Electronics Corp.*, *supra*, 485 U.S. at 725-26. Yet, under the dealer-service theory that we sketched, and other theories that have the support of antitrust economists, resale price maintenance does not impair any interest that the antitrust laws interpreted in light of modern economics could be thought intended to protect. It increases rather than reduces competition—as the Court recognized in the *Sylvania* decision, dealing with the closely related area of territorial and other nonprice restrictions placed by suppliers on competition among their dealers. Yet *Sylvania* itself reaffirms the per se rule against vertical price restrictions. 433 U.S. at 51 n. 18. The Court must think that preventing intrabrand price competition harms an interest protected by the antitrust laws even if the restriction increases competition viewed as a process for maximizing consumer welfare and even if a restriction that had

similar effects but was not an explicit regulation of price would be lawful. If this is what the Court believes—and it does appear to be the Court's current position, though not one that is easy to defend in terms of economic theory or antitrust policy—the Court may also think that interfering with the freedom of a dealer to raise prices may cause antitrust injury. We suspect not, but we cannot have sufficient confidence in our view to declare a decision of the Supreme Court that has not been expressly overruled nevertheless defunct, as we would have to do in order to agree with the district court's ruling that the maximum price provision in the contract between State Oil and Khan was not illegal per se. In *Atlantic Richfield*, despite the Court's evident skepticism about the continued soundness of *Albrecht*, the Court distinguished it on the ground that the dealers subject to a price ceiling imposed by their supplier, as distinct from their competitors, were the intended beneficiaries of *Albrecht*. See 495 U.S. at 336-37. The implication is that the injury to a dealer like Khan from not being able to raise his price because of a restriction imposed by his supplier is antitrust injury.

But even if Khan, as we believe, is not ruled out of court by the concept of antitrust injury, he had to prove injury in fact to be able to maintain the suit. The only evidence of injury was in the report of his economic expert, so if the judge did not abuse his discretion in excluding the report we must affirm the dismissal of the antitrust count even though we think he was wrong to think that *Albrecht* made it impossible for Khan to prove *antitrust* injury. But we think it was an abuse of discretion.

The judge's ground for the exclusion was that "the report turns entirely on the experience of one receiver who operated one gas station over a five-month period." Before Khan was terminated, State Oil issued a notice of termination and, on the ground that Khan was selling inventory in which State Oil retained a security interest without reimbursing State Oil, obtained from a state court an order appointing a receiver to operate the station. He did

so for five months. (The record does not reveal what happened at the end of that period. We assume that State Oil either took over the operation of the station itself or obtained another lessee.) The plaintiffs' expert obtained the receiver's financial records and determined from the cost and revenue figures in them that the receiver must have disregarded the price ceiling in the agreement with State Oil. The figures showed that the receiver had realized a margin on his sales of gasoline in excess of 3.25 cents. The only way he could have done this was by charging a price in excess of the suggested retail price and not rebating the higher margin generated by the higher price. The expert inferred that had Khan been allowed to raise his price above the suggested retail price, he would have had a higher income, enabling him to pay his rent and therefore avert termination.

Of course competitive conditions may have changed during the time the receiver was operating the station. A dealer's ability to raise his price depends on the demand for his product; the demand for gasoline in general, or for Union 76 relative to other brands, may have increased after the receiver took over. If so, his ability to maintain a price higher than the suggested retail price would not prove that Khan had had a similar ability. And if Khan could not have maintained a price above the suggested retail price, simply because competition would not have permitted him to do so, then he wasn't hurt by the contractual provision of which he complains. There would be a violation of the antitrust laws, but no injury.

But this is just to say that the evidence presented by the expert was not conclusive on the subject of injury—was, indeed, very far from being conclusive. That did not make it either inadmissible or devoid of probative value. The only ground on which it could be argued to be inadmissible would be that the expert, although a Ph.D. in economics from a reputable university and an experienced consultant in antitrust economics, and hence qualified to offer expert economic evidence in this case, had failed to conduct a study that satisfied professional norms. As we

have emphasized in cases involving scientific testimony—and the principle applies to the social sciences with the same force that it does to the natural sciences—a scientist, however reputable, is not permitted to offer evidence that he has not generated by the methods he would use in his normal academic or professional work, which is to say in work undertaken without reference to or expectation of possible use in litigation. *Braun v. Lorillard Inc.*, 84 F.3d 230, 234 (7th Cir. 1996); *Rosen v. Ciba-Geigy Corp.*, 78 F.3d 316, 318 (7th Cir. 1996); *Bammerlin v. Navistar Int'l Transportation Corp.*, 30 F.3d 898, 901 (7th Cir. 1994). The district judge identified no basis, and State Oil can point to none, for supposing that the expert's report flunked this test. The inference regarding the receiver's profit margin, drawn from the station's cost and revenue data, was straightforward, and, so far as appears, was made in just the way that an economist interested in a firm's profit margins for reasons unrelated to litigation would make it; and likewise the inference that if Khan had enjoyed the freedom that the receiver evidently thought *he* had he would have charged a higher price, and made more money, than he did. If anything, the economist was overqualified to give evidence that could as easily have been given by an accountant; but overqualification is not yet a recognized basis for disqualification.

Weight is different from admissibility. An expert's report might be admissible but so lacking in weight as not to block the granting of summary judgment for the other side. *Wittmer v. Peters*, 87 F.3d 916, 920 (7th Cir. 1996); *Mid-State Fertilizer Co. v. Exchange Nat'l Bank*, 877 F.2d 1333, 1338-39 (7th Cir. 1989); *Hayes v. Douglas Dynamics, Inc.*, 8 F.3d 88, 92 (1st Cir. 1993). But that is not the situation here. State Oil put in no evidence. In the absence of contrary evidence, Dr. Bamberger's inference from his study of the receiver's experience that Khan had been hurt by the maximum price provision of the gasoline supply contract was sufficiently plausible to defeat summary judgment on the question of injury.

The antitrust claim should not have been dismissed. We turn to the breach of contract claim. Although Khan's primary complaint is that he was prevented from raising his price, he also complains that there were times when he wanted to lower his price on nonpremium gasoline. As we said at the outset, this claim has no standing as an antitrust claim. But State Oil concedes that its contract implicitly obligated it to suggest retail prices (and adjust its wholesale prices accordingly, to maintain the 3.25 cents margin between wholesale and suggested retail price that the contract guarantees) that were realistic in light of competitive conditions facing Khan. The only evidence Khan presented concerning those competitive conditions was evidence that on sixteen occasions during his operation of the station he had called other dealers and been told that their retail prices were lower than the suggested retail prices fixed by State Oil. This evidence falls far short of establishing a genuine issue of material fact concerning a breach of the contract. There is no evidence that the dealers were actual competitors of Khan or that the prices charged by those dealers were prices for the same grades of gasoline sold by Khan, which, remember, sold a gasoline that has a well-recognized brand name. The evidence is perfectly consistent with an assumption that State Oil's suggested retail prices were competitively realistic.

So the contract claim was rightly dismissed but we note the absence from the record of any indication of why the district judge, having dismissed the federal claims before trial, retained rather than, as is the norm in such situations, relinquished jurisdiction over the supplemental state-law claim. 28 U.S.C. § 1367(c)(3); *Brazinski v. Amoco Petroleum Additives Co.*, 6 F.3d 1176, 1182 (7th Cir. 1993). (It does not appear that there is diversity of citizenship between the parties.) The presumption in favor of relinquishment when all federal claims fall out before trial is rebuttable, *id.*, but it should not be lightly abandoned, as it is based on a legitimate and substantial concern with minimizing federal intrusion into areas of purely state law.

Since the absence of merit of the supplemental claim in this case is clear as a matter of elementary contractual interpretation, so that the retention of jurisdiction for purposes of dismissing the claim did not require the district judge to speculate about the meaning of state law, we think the judge was right to retain jurisdiction rather than visit upon the parties and the state courts the burden of further litigation. As we said in *Brazinski*, citing a slew of earlier cases, if the correct disposition of the supplemental claim is so clear as a matter of state law that it can be determined without a trial and without entanglement in difficult issues of state law, considerations of judicial economy counsel retention and prompt decision, rather than remission to the state court. *Id.* But we remind the district courts of the presumption against retaining jurisdiction of supplemental state-law claims when the federal claims are dismissed before trial, and of the concomitant importance of stating the ground on which the court believes in a particular case that the presumption has been rebutted.

The judgment of the district court is affirmed in part and reversed in part, as explained in the opinion, and the case is remanded for further proceedings consistent with the opinion.

AFFIRMED IN PART,
REVERSED IN PART,
AND REMANDED.

RIPPLE, *Circuit Judge*, concurring. Today the court employs a rigorous application of the rules of stare decisis and precedent in this antitrust matter. This methodology is certainly, as a general proposition, a prudent approach to antitrust decision-making in the judicial context. Antitrust issues pose crucial policy choices for the economic and, indeed, social life of the Country. Nevertheless, Congress, content with the passage of generally worded statutes, has left a great deal of policy-making to the courts through the process of case by case decision-making. In these circumstances, we ought to ensure, through the strict application of stare decisis and precedent, that the law is sufficiently predictable and certain to permit businesses to order their affairs with a clear understanding of what the law requires. I agree, therefore, with the basic methodology employed by the court in reaching the decision announced today. I write separately to note that I share my colleagues' substantive criticism of the per se rule as it has been applied to vertical maximum price-fixing and to question the extension of that rule to cases like the present one in which the threat of horizontal cartelization is absent or, at the very least, greatly diminished. It is difficult to discern the "manifestly anticompetitive effect," *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 50 (1977), that justifies invocation of the per se rule.

The Supreme Court first applied the per se rule to vertical maximum price-fixing in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). The defendant in that case, a newspaper publisher, set a suggested retail price for its many distributors. When one of the distributors sought to charge his customers more than the suggested price, the publisher attempted to discipline him by hiring another entity to assume some of the business handled by the recalcitrant carrier. The Supreme Court held that this restraint was unlawful per se under section 1 of the Sherman Act because, as the Court later recounted in *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1989), the restraint "threatened to inhibit vigorous [price] competition by the

dealers who were bound by it" and because it "threatened to become a minimum price-fixing scheme." *Id.* at 335.[1]

The present case arises in a factual context that is far removed from the one at issue in *Albrecht*. This case, as presented to the district court and to this court on appeal,[2] involves a single contract between a single wholesaler and a single retailer that sets the equivalent of maximum resale price for the commodity in question. Neither the pleadings in this case nor the contract between Khan and State Oil implicate any other entities. We are confronted, therefore, with a wholly vertical arrangement; there is no hint of any concrete horizontal effect.

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[1] Although the Court in *Atlantic Richfield* referred to the situation in *Albrecht* as an "unadulterated vertical, maximum-price-fixing arrangement," *Atlantic Richfield*, 495 U.S. at 336 n.6, the harm identified in *Albrecht* was largely horizontal and stemmed from the fact that multiple dealers were subject to the restraint. At issue was "the manner in which [the arrangement] might restrain competition by dealers." *Id.* at 335.

[2] We note that Khan's complaint does contain the following allegation:

> At all times relevant to this action Defendant has been engaged in the business of leasing service stations/convenience stores such as that operated by Plaintiffs, as well as in the sale of petroleum and other products to such service stations for resale to the public under the "Union 76" trademark. Plaintiffs are informed and believe that Defendant is involved in the lease and/or operation of numerous other service stations in the Chicago Metropolitan Area.

R.1, Complaint, at ¶ 7. Although the final sentence of this paragraph arguably alleges the existence of other State Oil dealers, it is clear from the record in this case that Khan did not present the case to the district court on this theory. The summary judgment record is devoid of any evidence suggesting that other State Oil dealers also are subject to the price restraint challenged by Khan. Because the case was not presented to the district court on the theory that the restraint had been imposed by multiple wholesalers or upon multiple dealers, we do not view this unsupported allegation in Khan's complaint as sufficient to make this case factually analogous to *Albrecht*.

In *Center Video Industrial Co., Inc. v. United Media, Inc.*, 995 F.2d 735 (7th Cir. 1992), we discussed the centrality of the presence or absence of horizontal effects in determining whether a particular vertical restraint ought to be prohibited by the antitrust laws. Reviewing existing Supreme Court precedent addressing vertical restraints, we noted that, in the Supreme Court's view, "only one legitimate justification exist[s] for prohibiting vertical price restraints imposed by manufacturers who lack significant market power: a proved tendency for such agreements to facilitate the formation of horizontal cartels." *Id.* at 737. We addressed in *Center Video* the "two mechanisms" by which a vertical price maintenance agreement might be used to facilitate the formation of horizontal cartels. *Id.* First, we explained, vertical price maintenance arrangements facilitate cartelization at the retail level; the restraint provides a mechanism by which conspiring dealers are able to enforce the agreement against wayward members of the horizontal conspiracy. *See id.* at 737. We further noted that vertical price maintenance agreements may also assist in the formation of cartels at the manufacturer level. By requiring prospective members of a manufacturer cartel to impose price restraints on their dealers, cartel members have an effective method of determining whether their partners are abiding by the rules of the cartel. "The members of the cartel then need only monitor the retail prices of their partners' distributors, secure in the knowledge that any deviation from a given retail price would indicate that a member of the cartel had broken ranks . . . ." *Id.* at 738. In the absence of any allegation that the restraint at issue in this case was imposed by multiple manufacturers or upon multiple dealers, neither of these two justifications for application of the per se rule applies.

As my colleagues recognize, the anticompetitive implications of vertical price restraints are often difficult to discern. The difficulty in discovering actual injury to competition—or even the potential for such injury—is compounded where, as here, the price restraint in question is wholly vertical in nature and has been imposed by a

single wholesaler upon a single distributor. It simply is not clear that the plaintiff can show an "injury of the type that the antitrust laws were intended to prevent." *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977). Like my colleagues, therefore, I have serious doubts as to the continued viability of *Albrecht*—especially in the context of conduct that is devoid of horizontal anticompetitive implications. Our application of the per se rule to this limited restraint therefore marks a considerable extension of the *Albrecht* rule beyond the facts presented in that case.

Nevertheless, until the Supreme Court limits the use of the per se rule with respect to vertical price restraints, I am unable to rule out the possibility that the Justices might intend the per se rule to be broad enough to reach State Oil's conduct. Arguably, its action might be viewed as implicating some of the concerns articulated in *Albrecht*. For example, the Supreme Court in *Albrecht* explained that "[m]aximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which consumers desire and for which they are willing to pay." 390 U.S. at 153. By eliminating any motive for Khan to increase his prices above the suggested retail price, State Oil effectively may have relegated Khan to the discount gasoline market. *See Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 19 F.3d 745, 753-54 (1st Cir. 1994) (noting that, because the plaintiff dealer was forced to keep its price below the level it preferred to set, the challenged agreement forced the plaintiff to provide less of what customers wanted, leading to potentially lower profits). One less potential entrant in the full-service gasoline market means that dealers that market are able to charge a higher price for the same package of services. *See Albrecht*, 390 U.S. at 152 (noting that a vertical maximum-price agreement, "by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market").

The Supreme Court also noted in *Albrecht* that, by limiting the ability of small dealers to engage in nonprice competition, a maximum price-fixing agreement might "channel distribution through a few large or specially advantaged dealers." *Id.* Here, the net effect of the restraint imposed on Khan by State Oil is to limit Khan's margin to $0.325 per gallon—a margin which, in Khan's view, is unrealistically low. Over the long run, high-volume gasoline dealers, who are able to maintain low margins for longer periods of time, might benefit from the arrangement foisted on Khan by State Oil.

At some point in the future, the Supreme Court may revisit *Albrecht* and further define the scope of the per se rule in the context of vertical maximum price-fixing. Until that time, however, we cannot be sure whether the rule of *Albrecht* is broader than the facts which gave it birth. In the interim, considerations of stare decisis and precedent require us to continue to adhere to the per se rule against vertical maximum price-fixing in cases in which identifiable anticompetitive effects are present. Although the absence of concrete horizontal implications makes this a considerably closer case, State Oil's conduct does present, for the reasons outlined above and in the majority's opinion, at least the possibility of the anticompetitive effects identified by the Supreme Court in *Albrecht*. On this ground, therefore, I concur in the court's decision.

A true Copy:
Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT – WITH ORAL ARGUMENT

Date: August 29, 1996
BEFORE:

Honorable RICHARD A. POSNER, Chief Judge
Honorable JOEL M. FLAUM, Circuit Judge
Honorable KENNETH F. RIPPLE, Circuit Judge

No. 96-1309

BARKAT U. KHAN and KHAN & ASSOCIATES, INC., an Illinois corporation,

Plaintiffs-Appellants

v.

STATE OIL COMPANY, a corporation,

Defendant-Appellee

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 94 C 35—Charles R. Norgle, Judge

The judgment of the District Court is AFFIRMED in part and REVERSED in part, and the case is REMANDED in accordance with the decision of this court entered on this date. Costs are awarded to the appellant.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

Case Number: 94 C 35 Date: October 3, 1995

Name of Assigned Judge: CHARLES R. NORGLE

Case Title: BARKAT U. KHAN and KHAN & ASSOC., INC. v. STATE OIL CO.

* * * * *

DOCKET ENTRY:

* * * * *

/s/ Charles R. Norgle, Sr.

(10) ☒ [Other docket entry]

In Document # 68, the court struck Documents # 41-1, 45-1, 51-1, 59-1 and 60-1 with leave to reinstate should settlement negotiations fail. (Doc. # 68.) Settlement negotiations failed. The clerk shall reinstate the following: Defendant's motion for summary judgment (Doc. # 41-1); Plaintiff's motion for summary judgment (Doc. # 45-1); Defendant's motion to strike (Doc. # 51-1); Defendant's motion to bar the testimony of Gustavo E. Banberger (Doc. # 59-1); Defendant's motion in limine with respect to the expert testimony of Gustavo E. Bamberger (Doc. # 60-1).

* * * * *

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

Case Number: 94 C 35 Date: October 3, 1995

Name of Assigned Judge: CHARLES R. NORGLE

Case Title: BARKAT U. KHAN and KHAN & ASSOC., INC. v. STATE OIL CO.

* * * * *

DOCKET ENTRY:

* * * * *

/s/ Charles R. Norgle, Sr.

(10) ☒ [Other docket entry]

Plaintiffs' Motion for Reconsideration (received September 22, 1995) is denied. Plaintiff's Motion for Certification for Appeal of the court's minute order (Doc. #73) is granted pursuant to 28 U.S.C. § 1292(b). Pursuant to Federal Rule of Appellate Procedure 5(a), the minute order is amended to include the following statement: "The court finds that the issue addressed in this minute order (Doc. #73) 'involves a controlling question of law as to which there is substantial ground for difference of opinion, and that an immediate appeal from the order may materially advance the ultimate termination of the litigation.' 28 U.S.C. § 1292(b)." Fed. R. App. P. 5(a).

* * * * *

[Dated November 13, 1995]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

BARKAT U. KHAN and KHAN & ASSOCIATES, INC., an Illinois corporation,	)	
Plaintiffs,	)	No. 94 C 35
v.	)	Honorable Charles R. Norgle
STATE OIL COMPANY, a corporation,	)	
Defendant.	)	

OPINION AND ORDER

CHARLES R. NORGLE, SR., District Judge:

Before the court are the parties' cress-motions for summary judgment on Count II, and Defendant State Oil Company's ("State Oil") motion for summary judgment on Counts I and IV. Also before the court are State Oil's motion to strike Plaintiff's expert report, its motion to bar that expert's testimony, and its motion in limine regarding that expert's testimony. Plaintiff has indicated that he will voluntarily dismiss Count III.

I. BACKGROUND

Plaintiffs Barkat U. Khan ("Kahn") and Khan & Associates, Inc. ("K&A") (collectively "Plaintiffs") bring this action against State Oil claiming damages for violations

of the Petroleum Marketing Practices Act ("PMPA"), 15 U.S.C. §§ 2801-41 (Count I), the Sherman Antitrust Act ("Sherman Act"), 15 U.S.C. § 1 (Count II), and for breach of contract (Count IV). The court exercises jurisdiction over the PMPA and Sherman Act claims pursuant to 28 U.S.C. § 1331 and over the contract claim under its supplemental jurisdiction pursuant to 28 U.S.C. § 1367.

On January 20, 1992, Khan and State Oil Entered a written lease and supply agreement ("Agreement") regarding a gasoline service station (the "Station"). In relevant part, paragraph 31 of the Agreement provides:

> In order to assist in maintaining the competitive position of both Landlord and Tenant,The [sic] Landlord will from time to time establish a recommended retail pump price for each type of gasoline sold at the location. The Landlord shall charge the Tenant for each transport of gasoline at the recommended retail pump price less margin and sales tax. The Tenant's margin will be $0.0325 (three and 1/4 cents) per gallon. In the event the Tenant elects to sell at retail at a price in excess of the recommended retail pump price established by the Landlord, the Tenant shall pay the Landlord a sum equal to the difference between the retail pump price at which the gasoline in question has been sold, and the recommended retail pump price established by the Landlord multiplied by the number of gallons sold. In the event the Tenant elects to sell at a retail pump price below the recommended retail pump price established by the Landlord, the Tenant shall not be entitled to a reduction in price to cover the difference.

The Agreement also provides for rent in the amount of $7,500 per month in 1992, $8,000 per month in 1993, and $8,500 per month in 1994.

After execution of the agreement, Khan took possession of the Station and remained in possession from January 1992 to February 1993. During that time, pursuant to the Agreement, Plaintiffs purchased from State Oil and resold various grades of gasoline. Both parties agree that Khan was a franchisee and State Oil was a franchisor under the definitional provisions of the PMPA.

On January 27, 1993, State Oil issued a Notice of Termination, giving Plaintiffs five-days notice of State Oil's intent to terminate the Agreement as of February 2, 1993. State Oil explains that this notice was issued for non-payment of amounts owed. On February 8, 1993, State Oil brought a forcible entry and detainer action in DuPage County and a separate action to collect on the debt. The Circuit Court of the Eighteenth Judicial Circuit of Illinois appointed a receiver to operate the Station.

Khan removed State Oil's action to federal court, arguing that the PMPA applied. On May 12, 1993, the court denied State Oil's motion for summary judgment, because the court had not determined that, as a matter of law, State Oil's January 27, 1993 notice was reasonable. The court found that it did not have jurisdiction over State Oil as a plaintiff franchisor under the PMPA because the PMPA grants jurisdiction only over franchisee actions. *State Oil Co. v. Khan*, 839 F. Supp. 543 (N.D. Ill. 1993). By order of December 3, 1993, this court remanded the action back to DuPage County. In addition to the instant case in federal court, Khan filed state counterclaims and a third-party complaint in the remanded state collection action.

After the state court appointment of the receiver, State Oil issued a second notice of termination on May 29,

1993, providing for termination effective September 3, 1993. The receiver ran the Station from February until November 1993.

II. DISCUSSION

Summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56 (c); *Transportation Communications Int'l Union v. CSX Transp., Inc.*, 30 F.3d 903, 904 (7th Cir. 1994). The court evaluates all evidence in the light most favorable to the non-movants. *Serfecz v. Jewel Food Stores*, No. 94-3211, 1995 WL 567135, at *3 (September 26, 1995). To withstand summary judgment, disputed facts in a case must be those that might affect the outcome of the suit. *Tolle v. Carroll Touch, Inc.*, 23 F.3d 174, 178 (7th Cir. 1994). Summary Judgment is not a discretionary remedy and must be granted when the movant is entitled to it as a matter of law. *Anderson v. P.A. Radocy & Sons, Inc.*, No. 93-287, 1995 WL 572914, at *2 (7th Cir. Sept. 29, 1995). In the instant case, considering all facts in the light most favorable to the non-movants, there are no genuine issues of material fact which would allow this case to withstand summary judgment.

A. *K&A as a Party*

As a preliminary matter, State Oil contends that K&A is not a proper plaintiff in this action because the Com-

plaint alleges a contractual relationship only between Khan and State Oil. The PMPA offers protections only to a "franchisee," which is defined as "a retailer or a distributor . . . who is authorized . . . under a franchise . . . to use a trademark in connection with the sale . . . or distribution of motor fuel." 15 U.S.C. § 2801(4). The PMPA defines a "franchise" only in terms of a contractual relationship. 15 U.S.C. § 2801(1)(B). Khan was the only "retailer or distributor" in a contractual relationship with State Oil. Because K&A was not engaged in a contractual relationship with State Oil, it is not a protected "franchisee" under the PMPA. Thus, it is not a proper plaintiff under Count I of the Complaint.

Count II of the Complaint alleges a violation of antitrust law. State Oil contends that K&A does not have standing to bring this count because there was no contractual relationship between State Oil and K&A. Because antitrust law is designed to prevent many types of injuries, rather than simply contractual injury, courts should generally focus on antitrust injury requirements, rather than traditional contractual standing requirements, when deciding antitrust cases. *See Southwest Suburban Bd. of Realtors v. Beverly Area Planning Assoc.*, 830 F.2d 1374, 1377 n.1 (7th Cir. 1987). Because K&A may have been in a position to suffer potential antitrust injury, the court will not dismiss K&A's Count II, and will consider that count as it applies to both Khan and K&A.

Count IV alleges a state law contract claim. Again, because State Oil incurred no contractual duties to K&A under the facts presented, K&A does not have standing to bring this contractual claim against State Oil. *See*

White Hen Pantry, Inc. v. Cha, 214 Ill. App. 3d 627 (1991).

In sum, K&A does not have standing to bring Counts I and IV. As such, the court considers Counts I and IV as if they were brought by Khan individually.

B. *Petroleum Marketing Practices Act*

Khan alleges that State Oil violated the PMPA by its defective January 27, 1993, notice of intent to terminate the Agreement and by its action to appoint the receiver.[1] The court need not decide whether the January 27 notice was faulty for purposes of this order.[2]

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[1] Citing *Winks v. Feeney Oil Co.*, 731 F. Supp. 322, 327 (C.D. Ill. 1990), Khan asserts that State Oil has already conceded that its first notice was defective by issuing the second notice. The court respectfully disagrees with the *Winks* court. The court will not imply that a franchisor concedes a defective first notice when it issues a complying second notice. By punishing the issuance of a correct notice, the incentive for franchisors' to correct possible defective notices would be removed.

[2] Khan's response to State Oil's motion states:

> In the action before Judge Norgle prior to its remand, State Oil moved for summary judgment, which was denied by Order dated May 12, 1993. Judge Norgle found that the January 27, 1993 Notice of Termination . . . was not reasonable nor justified under the circumstances.

(Pls.' Mem. In Opp'n to Summ. J. at 4.) Khan seems to ignore the court's later opinion and order remanding the case to the Circuit Court of DuPage County, which explains:

> [T]he court has *not* already made a finding that State Oil's original notice of termination was defective or unreasonable. The court in its May 12, 1993 minute order on State Oil's motion for summary judgment found only that State

(continued...)

The PMPA provides franchisees the right to pursue equitable and legal actions against franchisors who fail to comply with the PMPA's notice provisions in terminating franchisees. 15 U.S.C. § 2805. The preliminary issue in a PMPA wrongful termination action is whether there was a termination. This issue arises from the requirement that a court's jurisdiction be secured by a justiciable case or controversy. *Naso v. Sun Ref. Mktg. Co.*, 582 F. Supp. 1566 (N.D. Ohio 1983) (citing *Alabama State Federation of Labor v. McAdory*, 325 U.S. 450 (1945)). The PMPA vest jurisdiction in federal district courts over matters involving the violation of 15 U.S.C. § 2802 (a), which states:

> [N]o franchisor engaged in the sale . . . or distribution of motor fuel in commerce may - (1) terminate any franchise . . . prior to the conclusion of the term, or the expiration date, stated in the franchise; or . . . (2) fail to renew any franchise relationship.

15 U.S.C. § 2802(a).

Khan alleges that the appointment of the receiver was a termination by State Oil pursuant to the January 27 notice. This court has already determined, in its minute order of September 11, 1995, that it will not construe the appointment of a receiver by the state court as a termi-

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[2] (...continued)

> Oil failed to convince the court that providing ninety-days notice would not have been reasonable as a matter of law. The court did not conclude the opposite: that ninety-days notice would not have been unreasonable, or that the five-day notice was itself unreasonable. That issue may thus be revisited. *State Oil v. Kahn*, 839 F.Supp. 543, 544 n.1 (N.D. Ill. 1993) (Norgle, J.) (emphasis added).

nation by State Oil under the PMPA.[3] The appointment was an action of the state court, rather than an action of State Oil. As such, that appointment cannot be viewed as a termination by State Oil flowing from its arguably-defective January 27 notice. Khan has not alleged any other act which could constitute a termination by State Oil in violation of the PMPA. Khan's failure to meet this jurisdictional requirement raises a serious doubt about the existence of a justiciable case or controversy. *See Halder v. Standard Oil Co.*, 642 F.2d 107 (5th Cir. 1981) (franchisee's fear of termination did not confer jurisdiction on the district court).

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[3] In part, the court's order states as follows:

> As a matter of law, the mere appointment of a receiver by the Circuit Court for the 18th Judicial Circuit did not constitute a termination of the contract between the parties. Generally, appointment of a receiver does not determine the rights of the parties. Rather, a receiver acts as an officer of the court, managing the property for the benefit of both parties. *First Nat'l Bank of Vandalia v. Trail Ridge Farm*, 143 Ill. App. 3d 244, 251 (5th Dist. 1986); *see also People ex rel. Scott v. Pintozzi*, 50 Ill. 2d 115 (1971); *In re marriage of Pick*, 167 Ill. App. 3d 294, 299 (2d Dist. 1988) (purpose of receivership is to prevent injury and avoid injustice).
>
> The decision to appoint a receiver lies within the discretion of the court. *Asset Guar. Reinsurance Co. v. American Nat'l Bank & Trust Co. Of Chicago*, 627 N.E.2d 179 (Ill. App. 1st Dist. 1993). State Oil's mere petition for a receiver could not have served as a termination of the agreement. Rather it was the court's discretionary decision that placed Plaintiff's property in receivership. The court's appointment of a receiver was not a termination of the franchise agreement by State Oil. September 11, 1995 (Doc. # 72).

Alternatively, Khan argues that he did not need to wait for State Oil to actually terminate his franchise before bringing a PMPA action against State Oil. Khan cites several cases where franchisees brought actions based on defective notices prior to actual termination. *See, e.g., Winks v. Feeney Oil Co., Inc.*, 731 F. Supp. 322 (C.D. Ill. 1990); *Thompson v. Kerr-McGee Refining Corp.*, 660 F.2d 1380 (10th Cir. 1981). However, these cases involve franchisees who were, unlike Khan, seeking injunctions against termination.

Nevertheless, Khan's argument is that the January 27 notice alone is enough to entitle him to damages. He contends that courts must not allow franchisors, like State Oil, to escape liability for harm caused by defective notices by later withdrawing those notices. Khan cites no authority for this proposition.

Furthermore, Khan does not allege that he was harmed by the January 27 notice. He alleges none of the injuries which PMPA plaintiffs in other cases have alleged. For example, as discussed above, he can not claim that an actual termination resulted from that notice. Also, because he did not bring a claim for injunctive relief, he cannot claim attorneys fees for seeking an injunction like the plaintiffs in *Winks* and *Lyons v. Mobile Oil Corp.*, 554 F. Supp. 199 (D. Conn. 1982). He does not claim resulting lost profits like the plaintiff in *Lippo v. Mobil Oil Corp.*, 776 F.2d 706 (7th Cir. 1985). Indeed, Khan claims in Count II that the receiver increased revenue and profits while operating Khan's franchise after the time of the defective notice.

In essence, Khan's argument amounts to an assertion that the issuance of any defective notice is a *per se* violation of the PMPA entitling a franchisee to trial and damages. Neither case law nor the PMPA recognize a *per se* violation of the PMPA by franchisors entitling franchisees to recovery. This court is unwilling to create such a violation of the PMPA based on allegations of a defective notice. A mere defective notice, without more, does not form a sufficient basis for an action under the PMPA.[4] Even viewing the facts in the light most favorable to Khan, there is no genuine issue of material fact which would allow Count I (PMPA) to survive summary judgment.

C. *Antitrust*

Both sides have moved for summary judgment on Count II.[5] Plaintiffs state that the pricing provisions in

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[4] The PMPA specifically provides that the court, rather than a jury, shall determine whether exemplary damages or attorney fees should be awarded. 15 U.S.C. § 2805 (d) (2)-(3). No case or statute recognizes a mere defective notice, without alleged injury, as a violation entitling a plaintiff to fees or exemplary damages. Accordingly, Khan has set forth no facts which could give rise to such an award.

[5] As a precursor to its antitrust discussion, the court notes the ambiguity of much of the current antitrust case law:

> [T]he courts . . . [have] . . . spawned an enormous body of interpretations and judgements without great uniformity or consistency. Almost any term in a contract that was alleged in one decisions to be . . . "anticompetitive," and thus illegal, has been found in another decision to be legal.

Armen A. Alchian & William R. Allen, *Exchange and Production: Competition, Coordination & Control* 272 (3d ed. 1983). The standards of summary judgment loom heavily in

(continued...)

the Agreement (set forth above) constituted verticial price-fixing, in that the Agreement prohibited Plaintiffs from increasing income by raising or lowering State Oil's recommended retail price.[6] Plaintiffs claim that, absent the Agreement's price constraints, Plaintiffs could have increased income by raising the price of premium grade gasoline and lowering the price of regular grades.

As proof of these assertions, Plaintiffs offer the report of Gustavo E. Bamberger ("Bamberger"). Plaintiffs aver that the receiver did not follow State Oil's recommended retail price and, therefore, that the receiver increased sales of gasoline. Plaintiffs also state that increased sales of gasoline would have resulted in a similar increase in ancillary sales.

In response, State Oil states that competition, rather than State Oil, prevented Plaintiffs from raising prices. State Oil notes that Plaintiffs were free to set any price they wished for the gasoline, although profits would be effected by setting a price different from the recommended price. State Oil also argues that Plaintiffs and their expert are merely speculating about the receiver's pricing methods and success, and that any success that the receiver may have had is not an indicator that Plaintiffs

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[5] (...continued)

the face of this ambiguity. The court acknowledges the challenge of demonstrating a genuine issue of material fact under such circumstances.

[6] Vertical price-fixing involves an agreement to set retail prices between a retailer and a wholesaler, as opposed to an agreement between two wholesalers or two retailers (horizontal price-fixing). *See Black's Law Dictionary* 1400 (5th ed. 1979).

could have performed similarly. In addition, State Oil asserts that Plaintiffs' reasoning regarding the relationship between ancillary sales and gasoline is faulty.

Plaintiffs respond that State Oil's recommended prices were not competitive. Plaintiffs draws this conclusion from a series of documented phone calls, in which Khan called-in the pump prices of his competitors. For each of these phone calls, Khan's recommended prices were higher than his competition's. In response, State Oil claims that Khan only called-in prices when he wished to request a wholesale price-reduction, and that Khan's documented prices are not generally representative of the relationship between Khan's prices and those of his competition.

Section One of the Sherman Act bans "[e]very contract . . . in restraint of trade or commerce." 15 U.S.C. § 1. Section One determinaticns proceed under one of two methods: "per se" or "rule of reason" analysis. The court already ruled, on September 12, 1995 (Doc. # 73), that the alleged violation must be considered under "rule of reason," and not "per se," analysis. That is, the court will weigh all circumstances of the case when determining whether the pricing provision is illegal for imposing an unreasonable restraint on trade. *See Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).[7]

To have standing in federal court pursuant to Article III of the Constitution, plaintiffs must demonstrate the

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[7] Under the "per se" analysis, a violative provision is one which makes "the likelihood of anti-competitive conduct so great as to render unjustified further examination of the alleged conduct." *Business Elecs. Cop. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724 (1988) (citation omitted).

existence of a case or controversy. *Slowiak v. Lank O'Lakes, Inc.*, 987 F.2d 1293, 1296 (7th Cir. 1993). In the antitrust context, a core component of the case or controversy demonstration is the requirement of an antitrust injury. *Serfecz v. Jewel Food Stores*, No. 94-3211, 1995 WL 567135 (7th Cir. Sept. 26, 1995). An antitrust injury is an "injury of the type the antitrust laws were intended to prevent and . . . [an injury flowing] . . . from that which makes defendants' acts unlawful." *Indiana Grocery, Inc. v. Super Valu Stores, Inc.*, 864 F.2d 1409, 1419 (7th Cir. 1989) (quoting *NCAA v. Bd. of Regents for the Univ. of Okla.*, 468 U.S. 85, 103 (1984)). The alleged injury must be palpable and distinct, rather than abstract, conjectural, or hypothetical. *Slowiak*, 987 F.2d at 1296. In considering the injury requirements of § 1 antitrust cases, although the court must draw all inferences from the underlying facts in the light most favorable to the non-movants, "antitrust law limits the range of permissible inferences from ambiguous evidence in a [§] 1 case." *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 822 F.2d 656, 660 (1987) (quoting *Matsushita Elec. Industrial Co. v. Zenith Radio Corp.*, 106 S. Ct. 1348, 1357 (1986)).

It is well-established that, in order to prove an agreement in restraint of trade, a plaintiff must show that the defendant's conduct actually had an adverse effect on all of competition in a relevant market. *Bunker Ramo Corp. v. United Bus. Forms, Inc.*, 713 F.2d 1272, 1283 (7th Cir. 1983). Proof of harm to single competitor is insufficient. *Okansen v. Page Mem. Hosp.*, 945 F.2d 696, 708 (4th Cir. 1991).

The plaintiff has the burden of demonstrating the relevant geographic market. *Nichols Motorcycle Supply Inc. v. Dunlop Tire Corp.*, No. 93 C 5578 1995 WL 529601, at

*31 (N.D. Ill. Aug. 8, 1995). That market is the geographic area in which a buyer may practically proceed to other sellers for goods or services, should the defendant seek to raise its prices. *Cogan v. Hargord Mem. Hosp.*, 843 F. Supp. 1013 (D. Md. 1994).

Furthermore, Rule of Reason analysis includes the general requirement that antitrust plaintiffs establish that the defendants had market power. *Valley Liquor*, 822 F.2d at 665 (7th Cir. 1987). That is, there must be a showing that defendants possessed the "power to raise prices significantly above the competitive level without losing all of one's business." *Id.*

Plaintiffs cannot meet their burden of showing an antitrust injury simply by alleging that they could have made more money by pricing products differently than they chose to. *See Slowiak*, 987 F.2d 1297-98. Instead, they must make some showing that the pricing provision caused them to lose money by forcing them to set prices which were artificial. *Slowiak* 987 F.2d 1297.

Courts must not trivialize the power of the Sherman Act by bestowing an aura of federal antitrust significance upon minor business disputes. Before receiving antitrust relief, plaintiffs must meet their burden of demonstrating the applicability of antitrust law to their dispute. Plaintiffs here have failed to demonstrate antitrust injury, harm to competition, a relevant market for analysis and market power. Accordingly, as a matter of law, Plaintiffs' allegations do not command the forces of the Sherman Act.

Plaintiffs have not even shown that they could prove that a difference in pricing would have increased their sales. Plaintiffs present the court with Bamberger's re-

port as support for their allegations that the pricing provisions of the Agreement caused the loss of the Station. Bamberger concludes that Plaintiffs would have increased their gross dollar margin if they had not followed State Oil's recommended retail price. He bases this conclusion on the undocumented assumption that the receiver did not follow the pricing provisions of the Agreement. State Oil denies that assumption. Bamberger states that the receiver showed an increase in profit and sales, which State Oil also denies. Bamberger's report also relies on a series of mathematical equations which rest on undocumented factual assumptions.

In addition, in drawing his conclusions, Bamberger notes, "The difference in . . . sales also may reflect, in part, changes in general economic conditions," although Bamberger states that he was able to isolate the effects of such changes from his calculations. (Rept. Of Gustavo E. Bamberger at 3.) He states that he isolated these effects by "assuming that absent the change in pricing policy, gallon sales at Plaintiffs' former location would have changed by the same percentage amount as total gasoline sales" in all of DuPage County. [Rept. Of Gustavo E. Bamberger at 4.] Bamberger's report makes no mention of why DuPage County is a relevant market for the analysis of Plaintiff's potential sales.

Moreover, Bamberger's report works on the unstated and unexplained assumption that five-months of the receiver's experience at a single station is a legitimate basis for analyzing Plaintiffs' experience at the same station prior to the receiver's appointment. He assumes that the receiver operated the Station in the same manner and competitive conditions as Plaintiffs. As an example of how the receiver operated the Station in the same

manner as Plaintiffs, Bamberger mentions only that the receiver and Plaintiffs followed the same hours of operation.

In an antitrust trial, the court would not admit Bamberger's report as evidence of antitrust injury. The report turns entirely on the experience of one receiver who operated one gas station over a five-month period which occurred after the alleged antitrust violation. The court would expect an expert to also consider trustworthy data reflecting the experience of other, similarly situated stations in a demonstrably relevant market. Bamberger has not done so.

From the assumption that the receiver made money while not following the pricing provisions, Bamberger draws the conclusion that Plaintiffs lost money while following the price provisions because of those provisions. The receiver's experience is not a sufficient basis for proving antitrust damages simply because the receiver's experience followed Plaintiffs'. *See Isaksen v. Vermont Castings, Inc.*, 825 F.2d 1158, 1165 (7th Cir. 1987) (when antitrust plaintiff attempted to prove lost profits by comparing profits for years before and after alleged unlawful activity, the court explained that *post hoc ergo propter hoc* is an invalid methodology for calculating damages, especially where other causal factors may have been at work); *See also Schiller & Schmidt, Inc. v. Nordisco Corp.*, 969 F.2d 410, 415 (7th Cir. 1992).

Furthermore, antitrust plaintiffs have the burden of showing a violation by a party with market power, *Valley Liquor*, 822 F.2d at 665, and that the violation had a negative effect on competition in the entire relevant market, not just to an individual competitor. *Tunis Bros.*

Co. Inc. v. Ford Motor Corp., 952 F.2d 715 (3d Cir. 1991); *see also GTE Sylvania*, 433 U.S. at 52. To hold otherwise would transform ordinary business disputes into antitrust claims. *See Ball Memorial Hosp., Inc. v. Mutual Hosp. Ins., Inc.*, 784 F.2d 1325, 1338 (7th Cir. 1986). In the instant case, Plaintiffs have not even attempted to demonstrate that State Oil had market power, or to demonstrate the effect of the pricing provisions on competition in a relevant market. Plaintiffs have, at most, shown a contractual injury to single competitor in an undefined market.

Bamberger's report does not even demonstrate that Plaintiffs would not have suffered but for the alleged antitrust violation, much less that the injury was of the sort of harm that antitrust laws were intended to prohibit. *See Jack Walters & Sons Corp. v. Morton Bldg., Inc.*, 737 F.2d 698, 707 (7th Cir. 1984) (holding that, even if a manufacturer engaged in price-fixing, its dealer, alleging only its own lost sales, could not bring an action for antitrust damages because antitrust laws were intended to prohibit damage to market competition rather than in individual business relationships). Thus, Plaintiffs have not submitted evidence of an antitrust injury.

Accordingly, Plaintiffs fail to meet the standing requirements of Sherman Act and lack antitrust standing. As a matter of law, considering all facts in favor of Plaintiffs, there is no genuine issue of material fact for trial.

D. *State Law Contract*

Finally, Khan argues that State Oil breached a covenant of good faith and fair dealing, which arose from the Agreement, because Khan was unable to change gasoline

prices at will while State Oil did not set its prices fairly to allow Khan to make a profit. Khan states that State Oil's wholesale gasoline prices were not competitive, in violation of the covenant of good faith.

For purposes of this motion, State Oil concedes that it did have an obligation under the Agreement to set a competitive recommended pump price. Therefore, State Oil agrees with Khan that State Oil would be in violation of that obligation if it set a recommended pump price (which was linked to the wholesale price) which was too high to be competitive. However, State Oil notes that, a low, and thus competitive, recommended pump price (linked to a low wholesale price) would not be in violation of its obligation. The court agrees. *See Atlantic Richfield*, 495 U.S. at 399 (low, non-predatory, prices are not anti-competitive). Khan can therefore only recover for breach of the covenant if he can present facts indicating that State's prices were too high to be competitive.

State Oil argues that Khan has presented no such facts. State Oil asserts that Bamberger's report consists of mere speculation, without supporting economic analysis.

Khan asserts that he need not establish that State Oil's prices were too high. Rather, he believes that he need only prove that State Oil breached its covenant of good faith. According to Khan,

> [The breach] . . . is amply shown by the fact that the Agreement itself is *per se* illegal under . . . the Sherman Act. The Agreement was thus void *ab initio*, and it necessarily follows that State Oil, by drafting, entering into, and enforcing the illegal pricing provisions, breached its covenant of good faith to Khan.

(Pls.' Mem.' in Opp. To Summ. J. at 20.) In sum, Khan argues that State Oil is liable for a breach of a void, unenforceable covenant.

In addition to this circular argument, Khan proceeds to defend Bamberger's report, arguing that it does demonstrate the anti-competitive nature of State Oil's pricing scheme. As discussed above, the court finds that the report rests on undocumented and unexplained assumptions which fail to demonstrate any anti-competitive injury. Consequently, Khan has offered no facts to support his legal conclusion that State Oil set its prices at anti-competitive levels. Khan has raised no genuine issue of material fact as to a breach of covenant of good faith and fair dealing.

III. CONCLUSION

Accordingly, Defendant's motion for summary judgment is granted as to Counts I, II, and IV and Plaintiff's motion for summary judgment as to Count II is denied. Defendant's motion to strike the expert report, its motion to bar, and its motion in limine are denied as moot.

IT IS SO ORDERED.

ENTER:

CHARLES RONALD NORGLE, SR., Judge
United States District Court

DATED: November 13, 1995

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

JUDGMENT IN A CIVIL CASE

BARKAT U. KHAN and KHAN & ASSOCIATES, INC.

v. CASE NUMBER: 94 C 35

STATE OIL COMPANY

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to a hearing before the Court. The issues have been heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that summary judgment is granted summary judgment is granted [sic] in favor of defendant State Oil Company and against plaintiffs Barkat U. Khan and Khan & Associates, Inc.

Date: November 13, 1995

Clerk: /s/ H. Stuart Cunningham

(By) Deputy Clerk: _____

(2)

Supreme Court, U.S.
FILED
JAN 2 1997
CLERK

No. 96-871

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN
and KHAN & ASSOCIATES

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTIONS PRESENTED FOR REVIEW

1. Did the court below properly decide that a gasoline dealer can demonstrate that he suffered antitrust injury from maximum retail price constraints imposed upon him?

2. Did the court below properly decide that an agreement between a gasoline supplier and a dealer which restricted the dealer's freedom to set retail prices for gasoline was a *per se* violation of the Sherman Act?

3. Did the court below properly determine that the trial court abused its discretion in excluding uncontradicted expert economic evidence establishing antitrust injury in the context of a summary judgment motion?

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REASONS FOR DENYING THE WRIT

Respondents, Barkat U. Khan and Khan & Associates, request that the Petition of State Oil Company for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit be denied.

I.

REVIEW OF THE ISSUES PRESENTED IS NOT WARRANTED

A. There Is No Conflict In Controlling Authority On The Illegality Of Maximum Vertical Resale Price Maintenance

Plaintiffs, Barkat U. Khan and Khan & Associates, challenged an agreement under which their ability to set the maximum retail price for gasoline was constrained as illegal under the antitrust laws. The trial court, refusing to apply the *per se* rule, dismissed the action because plaintiffs could not demonstrate antitrust injury.

The court below reinstated plaintiffs' antitrust action because plaintiffs could, under controlling authority, demonstrate antitrust injury arising from the challenged price restraints. Relying on *Albrecht v. Herald Company*, 390 U.S. 145, 88 S.Ct. 869 (1968) and *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 110 S.Ct. 1884 (1990), the court below found that a dealer may suffer antitrust injury when its supplier restricts the ability to freely set the resale price for its products according to the dictates of market forces. This decision is not in conflict with any controlling authority.

In *Albrecht*, this Court held that the action of a newspaper publisher in fixing the maximum price at which its distributors could resell the newspaper was illegal *per se*.

This Court made quite clear that even vertical maximum price fixing is illegal *per se*.

In the court below, State Oil argued that *Albrecht* should be ignored as it was no longer good law. The Seventh Circuit rejected State Oil's invitation to overrule *Albrecht*. The decision to continue to apply *Albrecht* is consistent with the First Circuit's decision in *Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiensgesellschaft*, 19 F.3d 745, 752-54 (1st Cir. 1994).

In an effort to avoid this authority, State Oil argues that post-*Albrecht* decisions regarding antitrust injury have superseded *Albrecht*. However, this Court in *Atlantic Richfield* specifically found that dealers, such as plaintiffs, suffered antitrust injury when their ability to freely set prices was constrained by a scheme of vertical maximum resale price maintenance. This Court has determined that the antitrust laws were intended to provide relief for a constrained buyer that loses its ability to compete due to maximum resale price maintenance.

Petitioner cites no conflicting decision. Consequently, this Court has no reason to review the issue in this case.

B. The Court Should Not Reconsider Controlling Precedent In This Case Which Was Decided On A Motion For Summary Judgment

Petitioner, recognizing the overwhelming authority supporting the decision below, requests that *Albrecht* be overturned. However, this case is not the appropriate case for the re-evaluation of *Albrecht*. This case, which was decided in the district court on a motion for summary judgment, does not present the issues in a proper context.

The decision of the Seventh Circuit merely sent this case back to the district court for trial. Respondents must

still present their case to the trier of fact. It is conceivable that the trier of fact will determine on the evidence presented that plaintiffs cannot prove antitrust injury as a matter of fact. In that case, this Court would not be required to address the legal issue of whether antitrust injury could ever arise in a case of vertical maximum resale price maintenance.

Moreover, plaintiffs can still present a rule of reason case to the trier of fact based on their expert economic evidence. Because plaintiffs could prevail on the rule of reason, this case does not clearly present the legal issue of the continued application of the *per se* rule to vertical maximum resale price maintenance.

Given this procedural posture, this Court should not review the issues raised in this case.

II.

THE COURT BELOW FULLY CONSIDERED AND PROPERLY DECIDED THE ISSUES

A. Plaintiff Has Demonstrated Antitrust Injury

Underlying State Oil's argument is the mistaken belief that this Court will restrict the concept of antitrust injury. However, as the court below noted, this Court has consistently adhered to a definition of antitrust injury broader than that espoused by State Oil.

This Court has continued to recognize vertical minimum price fixing as *per se* illegal despite theoretical objections from antitrust economists. *See, e.g., Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988). Since, as this Court recognized in *Albrecht*, the economic effect of vertical maximum price fixing begins to resemble the economic effects of minimum price fixing at certain

price levels, the court below properly held that antitrust injury could exist. No authority suggests that the injury to a dealer in plaintiffs' position is not antitrust injury.

B. The Trial Court Improperly Refused To Consider Plaintiffs' Expert's Opinions

The court below found that the trial court's refusal to consider the expert economic evidence submitted by plaintiffs to be an abuse of discretion. State Oil argues, without citation to any authority, that this economic evidence was inadmissible because there was no explanation of "how he got from the bottom line to the ultimate question". This argument misconstrues the law and the record.

The record, as the court below noted, included the financial records from which plaintiffs' expert determined the cost and revenue figures he used in his analysis. The expert's opinions were generated by the methods an economist would be expected to use in determining profits. No contrary evidence was presented. This evidence satisfies the test established in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 113 S.Ct. 2786 (1993). Importantly, State Oil can site no case which excluded the type of evidence presented by plaintiffs.

In the absence of any contrary evidence, the court below properly ruled that the trial court's refusal to consider the expert economic evidence was an abuse of discretion.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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(3)

Supreme Court, U.S.
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No. 96-871

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN and KHAN & ASSOCIATES, an Illinois Corporation,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

There are only two questions presented by State Oil's Petition and Khan's Response. Does this case present issues which should be considered by this Court, and does this case properly present those issues?

I.

THE ISSUES PRESENTED BY THIS CASE REQUIRE CLARIFICATION BY THIS COURT

As set forth in the Petition filed in this cause, significant questions remain concerning the decision in *Albrecht v. Herald Company*, 390 U.S. 145, 88 S.Ct. 869 (1968). These are questions about the applicability of *per se* liability to vertical price fixing, either maximum or minimum, and questions about the application of standards for "antitrust damages," as defined since *Albrecht*, to maximum price fixing cases.

Respondent states that there are no conflicting decisions by the lower courts. The lower court in this case stated that it agreed with the decision of the trial court, that the injuries claimed by Plaintiff did not fit within the definition of "antitrust injury." That court felt, however, that until this Court took some action clarifying *Albrecht*, it was obligated to reverse. The lack of conflicting decisions results solely from the fact that the lower courts are looking to this Court for guidance, and are reluctant to appear to be overruling Supreme Court decisions.

The questions presented are not merely theoretical, of interest only to scholars. These questions affect the relationship between every single supplier and dealer in the

United States. The existing interpretations reduce the potential for the use of price reduction to enhance competition between suppliers and between brands. Suppliers are entitled to reduce the price which they charge to dealers, but they may not force the dealer to pass that reduction on to the public. The potential for this type of restriction to either reduce or enhance competition at the consumer level is a question which may affect the prices paid by every person in this country. Economic and legal analysis suggest that a *per se* inquiry must be based on something more than categorizations.

II.

THIS CASE PROPERLY PRESENTS THOSE ISSUES IN A FORM APPROPRIATE FOR CONSIDERATION BY THIS COURT

Respondent also contends that this case is not an appropriate vehicle for consideration of these questions, because it was decided on a motion for summary judgment. His argument that something different may result upon a trial of the cause which will either eliminate the need for further action in the case or clarify the questions presented is subject to three concerns.

First, any alteration of the case will occur only if the trial court does not follow the mandate of the Court of Appeals. If the mandate of the Court of Appeals is followed, the same questions will exist at the end of the trial as exist at this time. Second, those questions may then have been settled by the fact that the decision of the Court of Appeals will have become the law of the case. Third, the mere fact that there is some possibility that this particular case may go away is not a reason not

to resolve questions which seriously affect the manner in which goods are merchandised. That possibility always exists when a trial court ruling has been reversed.

This case clearly presents the question of vertical maximum price fixing. The case involves only two parties, one supplier and one dealer. There is no question of any involvement by any other party.

This case clearly presents the question of antitrust damages. Respondent's sole evidence of injury is that presented by its expert. The expert claimed that a party who operated the station a year later earned a higher profit margin than that permitted to Respondent. The expert assumed that Respondent would, therefore, have been able to earn that same margin, had Respondent not been constrained by his contract with Petitioner. There is no reference to competition, either in terms of its effect on Respondent's ability to raise prices, or in terms of Respondent's effect on competitors. There is no contention of a reduction in Respondent's ability to provide services, and no claim of any attempt to benefit any other dealer. The sole damage claim is that Respondent was in a position to earn more money by raising prices to the consumer, and Petitioner prevented him from doing so. The court below did not decide that a gasoline dealer *could* demonstrate that he had suffered an injury from price constraints; it decided that it was obligated to hold that the injury claimed by this dealer was an "antitrust injury".

The questions presented in this case were not settled in either *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988) or *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 110 S.Ct. 1884 (1990).

In *Business Electronics*, this Court removed from the *per se* category vertical restraints which do not include some agreement on prices. There is no statement that vertical restraints which do include some agreement on prices would necessarily remain in the *per se* category. In fact, the concept of analysis by category was severely criticized.

Atlantic Richfield did not hold that dealers, such as Respondent, suffered antitrust injury when the ability of the dealer to freely set prices was constrained by a scheme of vertical maximum resale price maintenance. If that were correct, and Respondent could establish that it suffered any causally related injury, then the injury which he suffered would be antitrust injury. *Atlantic Richfield* was filed by a competitor, and this Court decided that the injury asserted by a competitor did not resemble any of the potential dangers described in *Albrecht*. This Court merely distinguished *Albrecht*, stating merely that it assumed *arguendo*, that *Albrecht* had been correctly decided. Citing *Cargill v. Monfort of Colorado, Inc.*, 479 U.S. 104, 107 S.Ct. 484, 93 L.Ed.2d 427, this Court went on to state that injury, although causally related to an antitrust violation, nevertheless will not qualify as "antitrust injury" unless it is attributable to an anti-competitive aspect of the practice under scrutiny.

Petitioner is not requesting that this Court restrict "antitrust damages." Petitioner is requesting this Court to consider the possibility that rigid adherence to an earlier decision is in conflict with the principles expressed by this Court in subsequent decisions.

Neither the holding in *Business Electronics* nor the holding in *Atlantic Richfield* considered these issues in a direct sense. In each case, the rationale presented would, if applied to this case, require a reversal of the decision of the lower court. The issues presented in this case are significant. They can be clarified only by a decision by this Court. Those questions are clearly presented by the case in its present status.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

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No. 96-871

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN and KHAN & ASSOCIATES, an Illinois Corporation,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED NOVEMBER 27, 1996
CERTIORARI GRANTED FEBRUARY 18, 1997

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The following opinions, orders, and pleadings have been omitted in printing this joint appendix because they appear on the following pages in the appendix to the Petition for Writ of Certiorari:

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CHRONOLOGICAL LISTING OF RELEVANT DATES

January 4, 1994	Civil complaint and demand for jury trial filed.
May 19, 1994	Affidavit of Barkat U. Khan
June 30, 1994	Statement of material facts in opposition to plaintiff's motion for summary judgment
March 24, 1995	Motion by defendant, State Oil Company for summary judgment
March 24, 1995	Memorandum by defendant in support of motion for summary judgment
March 24, 1995	Local Rule 12(M) statement of material facts by defendant.
March 29, 1995	Minute order scheduling motions.
June 26, 1995	Motion by plaintiffs for summary judgment on Count II
June 26, 1995	Local rule 12(M) statement in support of plaintiff's motion for summary judgment
June 26, 1995	Memorandum by plaintiffs in support of their motion for summary judgment
June 26, 1995	Memorandum by plaintiffs in opposition to defendant's motion for summary judgment

June 26, 1995	Local rule 12(N) statement by plaintiffs in response to defendant's motion for summary judgment
June 26, 1995	Memorandum by defendant in opposition to plaintiff's motion for summary judgment
June 26, 1995	Motion by defendant to strike the report of Gustavo E. Bamberger
June 26, 1995	Memorandum by defendant in support of defendant's objection to report
June 26, 1995	Rule 12 statement in response to plaintiff's summary judgment motion
June 26, 1995	Response by defendant to plaintiff's rule 12(N) statement
June 26, 1995	Reply by defendant to plaintiff's memorandum in opposition to defendant's motion for summary judgment
June 26, 1995	Affidavit of Diana Longely
July 7, 1995	Memorandum by plaintiff in opposition to defendant's objection and motion to strike
July 7, 1995	Declaration of Barkat U. Khan in support of memorandum in opposition to motion to strike
July 7, 1995	Declaration of Gustavo E. Bamberger

September 12, 1995	Minute order rule in limine that "rule of reason" and not "per se rule" applies in this case
October 3, 1995	Minute order denying plaintiff's motion for reconsideration and granting plaintiff's motion for certification
October 16, 1995	Supplemental response by plaintiff to motion for summary judgment
October 16, 1995	Supplemental memorandum by defendant in support of motion for summary judgment
November 13, 1995	Opinion and order
November 13, 1995	Minute order granting State Oil's motion for summary judgment
November 13, 1995	Entered judgment
December 15, 1995	Notice of appeal

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

BARKAT U. KHAN and KHAN & ASSOCIATES, INC., an Illinois Corporation,	)	
Plaintiff,	)	JURY TRIAL DEMANDED
vs.	)	GEN. NO.
STATE OIL COMPANY, a corporation,	)	
Defendants.	)	

COMPLAINT

Plaintiffs Barkat U. Khan and Khan & Associates, Inc., by the Law Office of Gregory J. Ellis and Davis, Mannix & McGrath, their attorneys, and for their complaint against State Oil Company, allege as follows:

ALLEGATIONS COMMON TO ALL COUNTS

1. This is an action for damages and other relief arising out of violations of the Petroleum Marketing Practices Act ("PMPA") (15 U.S.C. § 2801 *et seq.*), the Sherman Antitrust Act (the "Sherman Act") (15 U.S.C. § 1 *et seq.*), and breach of a written lease and supply agreement between the parties.

2. Jurisdiction over the Sherman Act and PMPA claims exists under Section 1331 of the Judicial Code (28 U.S.C. § 1331), Section 4 of the Sherman Act (15 U.S.C. § 4), and Section 4 of the Clayton Act (15 U.S.C. § 15),

and jurisdiction over the breach of contract claim exists under the supplemental jurisdiction of this Court.

3. Plaintiff Khan is an individual residing in DuPage County, Illinois, and is the sole shareholder of Khan & Associates, Inc., an Illinois corporation.

4. During the period from January, 1992 to about February, 1993, Plaintiffs operated a service station/ convenience store at 246 West Lake Street in Addison, Illinois under the "Union 76" trademark.

5. Plaintiffs operated the service station/convenience store under a written lease/supply agreement entered into by the Defendant and Plaintiff Khan on or about January 20, 1992, and entitled "Service Station/Convenience Store Lease/Supply Agreement" (the "Agreement"). A copy of that Agreement is attached as Exhibit A to the Complaint and refers to Plaintiff Khan as "Tenant" and Defendant as "Landlord."

6. Plaintiffs are informed and believe that Defendant is a corporation organized and operating under the laws of Illinois.

7. At all time relevant to this action Defendant has been engaged in the business of leasing service station/convenience stores such as that operated by Plaintiffs, as well as in the sale of petroleum and other products to such service stations for resale to the public under the "Union 76" trademark. Plaintiffs are informed and believe that Defendant is involved in the lease and/or operation of numerous other service stations in the Chicago Metropolitan Area.

8. Plaintiffs are a franchised dealer and Defendant is a franchisor under the provision of the PMPA, 15 U.S.C. § 2801(3).

COUNT 1 - PMPA VIOLATION

1. In a letter dated January 27, 1993, Defendant gave notice to Plaintiff Khan of its intent to terminate the Franchise Agreement effective February 2, 1993, contrary to the terms and provisions of the PMPA, 15 U.S.C. § 2802(a) and (b)(1). Said letter is attached hereto as Exhibit B and by this reference is incorporated herein.

2. Defendant's notice of termination is contrary to the requirements of the Petroleum Marketing Practices Act, including, but not limited to, at least one or more of the following:

(a) Defendant's notice failed to give ninety (90) days notice before the effective date of termination;

(b) It was not reasonable under the circumstances to give less than 90 days notice; and

(c) By taking action to appoint a receiver in state court, Defendant circumvented the provisions of the PMPA.

3. As a direct and proximate result of said wrongful termination, Plaintiffs have lost their Union 76-branded business and Plaintiff Khan's initial investment of more than $100,000.00.

4. Said notice of termination was in willful disregard of the requirements of the PMPA and the rights of Plaintiffs, and Plaintiffs are entitled to exemplary damages pursuant to 15 U.S.C. § 2805(d)(1)(B).

WHEREFORE, Plaintiffs pray for:

(1) Judgment in favor of Plaintiffs and against Defendant for such damages as Plaintiffs have sustained as a result of Defendant's actions in wrongfully terminating

the Franchise Agreement between the parties, in an amount to be determined at trial, as well as exemplary damages of $500,000;

(2) Plaintiff's attorney's fees expert witness fees, costs, and disbursements incurred herein as a result of Defendant's actions pursuant to 15 U.S.C. § 2805(d)(1)(C); and

(3) Such other and further relief as this Court finds just and appropriate.

COUNT II - SHERMAN ACT VIOLATION (RESALE PRICE FIXING)

1. Paragraph 31 of the Agreement is entitled "Petroleum Products Supply Agreement" (the "PPSA") and purports "to assist in maintaining the competitive position" of Plaintiffs and Defendant by allowing Defendant to fix and control the prices at which Plaintiffs resold gasoline to the public. Specifically, paragraph 31 of the Agreement provides that:

> The Tenants margin will be $0.0325 (three and ¼ cents) per gallon. In the event the Tenant elects to sell at retail at a price in excess of the recommended retail pump prices established by the Landlord, the Tenant shall pay the Landlord a sum equal to the difference between the retail pump price at which the gasoline in question has been sold, and the recommended retail pump price established by the Landlord multiplied by the number of gallons sold. In the event the Tenant elects to sell at a retail pump price below the recommended retail pump price established by the Landlord, the Tenant shall not be entitled to a reduction in price to cover the difference.

(*See* Exhibit A at ¶31.) The stated $0.325 margin applies to cash sales only. When Plaintiffs' customers chose to purchase gasoline on credit, the margin fell to approximately $0.02 due to fees, discounts, and/or other charges associated with the use of credit cards. (See Exhibit A at ¶32).

2. The PPSA, by its express terms, interfered with and restricted the ability of Plaintiffs to freely and openly set the prices of the gasoline which they resold to the public. Plaintiffs were unable to charge either higher or lower prices than the recommended retail pump price, which pricing would have enabled them to obtain a profit-maximizing price mix for their gasoline products.

3. The PPSA therefore constitutes a restraint of trade which is unreasonable and also constitutes a *per se* violation of Section 1 of the Sherman Act. 15 U.S.C. § 1.

4. As a direct and proximate result of said violation, Plaintiffs have sustained substantial damages in an amount believed to be in excess of $1,000,000 (before trebling), but to be specifically determined herein, including lost sales and profits on the sale of both petroleum and non-petroleum products, and the ultimate loss of Plaintiffs' service station business. Plaintiffs have thereby been injured in their business and property by reason of said antitrust violation.

5. Plaintiffs are entitled to treble damages and costs of suit, including attorney's fees, in an amount to be determined herein by reason of said Sherman Act violation. Plaintiffs are also entitled to interest on the damages as stated herein. 15 U.S.C. § 15.

WHEREFORE, Plaintiffs pray for entry of judgment against Defendant State Oil Company in an amount to

be determined herein, the trebling of said damages, together with attorney's fees, costs, interest, and such other relief as this Court deems proper.

COUNT III - SHERMAN ACT VIOLATION (TYING)

1. Plaintiffs reallege and incorporate by reference the allegations contained in Paragraph 1 of Count II of their Complaint.

2. The PPSA contained in the lease/supply Agreement of January, 1992 further provides in relevant part that:

> Tenant agrees to purchase all petroleum products from Landlord. . . . Tenant is to purchase such items from Landlord at competitive market prices.

(*See* Exhibit A at paragraph no. 31.)

3. By requiring Plaintiffs "to purchase all petroleum products from Landlord", Defendant tied the purchase and sale of petroleum products to the lease of the premises at 246 West Lake Street, Addison, Illinois, and thereby unreasonably restrained a non insubstantial amount of trade and commerce in the purchase and sale of said petroleum products, in violation of Section 1 of the Sherman Act. 15 U.S.C. § 1.

4. As a direct and proximate result of said violation, Plaintiffs were precluded from freely purchasing petroleum products from other suppliers at fair and competitive prices.

5. Plaintiffs have sustained substantial damages by reason of said unlawful tie-in an amount to be determined herein and which include, but are not limited to, the following: 1) the payment of non-competitive prices for petroleum products; 2) the loss of sales and profits on

the sale of both petroleum and non-petroleum products; and 3) the ultimate loss of Plaintiffs' service station business. Plaintiffs have thereby been injured in their business and property by reason of said antitrust violation.

6. Plaintiffs are entitled to treble damages and costs of suit, including attorney's fees, in an amount to be determined herein by reason of said Sherman Act violation. Plaintiffs are also entitled to interest on the damages as stated herein. 15 U.S.C. § 15.

WHEREFORE, Plaintiffs pray for entry of judgment against Defendant State Oil Company in an amount to be determined herein, the trebling of said damages, together with attorney's fees, costs, interest, and such other relief as this Court deems proper.

COUNT IV - BREACH OF COVENANT OF GOOD FAITH AND FAIR DEALING

1. Plaintiffs reallege and incorporate by reference the allegations contained in Paragraph 1 of the Count II of their Complaint.

2. Because of Defendant's ability to change posted gasoline prices at will, there is implied in the PPSA set out in paragraph 31 of the Agreement a covenant that Defendant will exercise its ability to change posted prices in good faith and will deal fairly with Plaintiffs in so doing.

3. During the time Plaintiffs operated said service station, Defendant, without regard for the ability of Plaintiffs to sell gasoline and other products on a profitable basis, set posted prices at artificially high and/or

low levels, thereby interfering with Plaintiffs' ability to compete in the gasoline market.

4. Moreover, the prices which Plaintiffs paid to Defendant for petroleum products and, in particular, for gasoline pursuant to paragraph no. 31 of Exhibit A were not competitive market prices as required by the PPSA.

5. Defendant's actions violated the covenant of good faith and fair dealing implied in the PPSA.

6. As a direct and proximate result of Defendant's action in setting the retail price of gasoline sale by Plaintiffs at the service station, and in setting the wholesale price of the petroleum products, Plaintiffs have suffered a substantial loss of sales and profits on the sale of gasoline and other petroleum products, as well as on the sale of food and other products sold at the service station, and the ultimate loss of Plaintiffs' service station business.

WHEREFORE, Plaintiffs pray for entry of judgment against Defendant State Oil Company in an amount to be determined herein, together with attorney's fees, costs, and such other relief s this Court deems proper.

BARKAT U. KHAN and KHAN & ASSOCIATES, INC., Plaintiffs

By:_____
One of their attorneys

Counsel
Gregory J. Ellis
1301 West 22nd Street
Suite 407
Oak Brook, IL 60521
(708) 572-1175

Champ W. Davis, Jr.
I.D. No. 00587192
David C. Bogan
Denise Michael Kaplan
Davis, Mannix & McGrath
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Chicago IL 60603
(312) 332-3033

JURY TRIAL DEMANDED

Plaintiffs, Barkat U. Khan & Associates, Inc., respectfully request a trial by jury as appropriate on their claims for relief.

Dated: January 4, 1994.

SERVICE STATION/CONVENIENCE STORE LEASE/ SUPPLY AGREEMENT

This lease, made and entered into this 20th day of January, 1992, by and between State Oil Company with its principal offices at 400 S. Curran Road, Grayslake, Illinois 60030, hereinafter call Landlord and U. Khan (Bob) Barkat 8124 S. Garfield Avenue, Burr Ridge, IL 60521 (708) 920-9786, hereinafter called Tenant,

WITNESSETH:

The Landlord, for and in consideration of the covenants and agreements hereinafter set forth to be kept and performed by the Tenant, demises and leases to the Tenant, and the Tenant does hereby take, accept, and rent from the Landlord the premises hereinafter described. For the period, at the rental, and upon the terms and conditions hereinafter set forth:

Demised Premises

1. The Landlord leases to the Tenant, and the Tenant rents from the Landlord, the premises known as ADDISON 76 246 W. Lake Street, Addison, IL 60101 with the legal description as follows:

SEE ATTACHED SCHEDULE A

Term of Lease

2. The term of this lease shall commence on 1/20/92 as hereinafter defined, and shall continue for a period of three years expiring without notice on 1/19/95. Landlord and tenant shall have the option to renew this lease/ supply agreement at the end of the term stated herein.

Occupancy Date

3. The obligation to pay rent shall begin 1/20/92. The Tenant shall be entitled, effective 1/20/92 to begin preparing the property for its occupancy hereunder and shall be entitled to whatever possession is necessary for that purpose. As of 1/20/92 the Tenant shall assume all responsibilities for protection of the property and the equipment on the property.

Use of Premises

4. Tenant shall occupy and use the leased premises exclusively for the retail sale of gasoline and allied petroleum products supplied by the Landlord and for the operation of a convenience grocery store and the retail sale of all nature of merchandise generally associated with such operations, The Tenant shall continuously and uninterruptedly during the term of this lease conduct its customary business activity therein during all normal business days and during the Tenant's customary hours, not less than 24 hours daily and 7 days a week unless prevented from doing so by strike, fire, casualty or other causes beyond the Tenant's control and except during reasonable periods for repairing, cleaning and decorating the leased premises. If the Tenant shall abandon or close the premises for a period of 24 hours or more during any calendar year, Landlord shall have the right to treat this lease as terminate and to retake possession of the premises.

Security Deposit

5. Upon the unsealing hereof the Tenant shall deposit with the Landlord the first month's rent and a security deposit for an amount equal to the last month's rent provided in the schedule above. The security deposit shall be

held by the Landlord to assure faithful performance of the rent payments contained herein and the return of the premises in an acceptable manner to Landlord.

Title and Possession

6. Landlord covenants and warrants that it has full right and authority to enter into this lease for the full term hereof. Landlord further covenants that Tenant, upon paying the fixed annual rent provided for herein, and upon performing the covenants and agreements of this lease to be performed by said Tenants will have, hold and enjoy quiet possession of the leased premises.

Origination and Going Concern Fee

7(a). The tenant shall pay an Origination Fee of Seventy-five Thousand Dollars ($75,000.00). The tenants shall pay a refundable origination fee of Twenty-five Thousand Dollars ($25,000.00) upon the execution of this agreement and the balance of Fifty Thousand Dollars ($50,000.00) upon possession of the demised premises.

7(b). The parties recognize and agree that the demised premises is a going concern and as such is a value to the tenant, in recognition thereof the tenant agrees to pay a going concern fee of twenty-five Thousand Dollars ($25,000.00) upon possession of the demised premise on 1/20/92.

Rent

8. Tenant hereby agrees to pay rent to the Landlord at 400 S. Curran Road, Grayslake, Illinois 60030 or at such place directed in writing from time to time by Landlord.

Tenant shall pay to Landlord by the first day of each month in advance, the fixed rental as set forth

below. Failure of Tenant to meet rental payment terms will result in a penalty of $5.00 per day for the first 15 delinquent days and $10.00 per day thereafter until all monies are received by the Landlord.

	Rent per Month
1/20/92-1/31/92 (prorated-11 days)	$ 2,661.34
2/1/92-1/19/93	$ 7,500.00
1/20/93-1/19/94	$ 8,000.00
1/20/94-1/19/95	$ 8,500.00

Note: Any partial months will be prorated.

Holding Over

9. Tenant will, at the termination of this lease by lapse of time or otherwise, yield up immediate possession to Landlord, and failing so to do, will pay as liquidate damages for the whole time such possession is withheld, the sum of THREE HUNDRED Dollars ($300.00) per day; but the provisions of this clause shall not be held as a waiver by Landlord of any right of re-entry as hereinafter set forth; nor shall the receipt of said rent or any part thereof, or any other act in apparent affirmance of tenancy, operate as a waiver of the right to forfeit this lease and the term hereby granted for the period still unexpired for a breach of the covenants herein.

Confession of Judgment

10. Tenant does hereby irrevocably constitute any attorney of any Court of Record in any State or of the United States, attorney for him and in his name, from time to time, to waive the issuance of process and service thereof, to waive trial by jury, to confess judgment in favor of Landlord, his heirs, executors, administrators, successor or assigns, and against Tenant, for the amount of rent which may be in default by virtue of the terms

hereof, with the costs of such proceedings, and a reasonable sum for plaintiff's attorney's fees in or about the entry of said judgment, and for said purposes to file in said cause his cognovit thereof, and to make an agreement in said cognovit, or elsewhere, waiving and releasing all errors which may intervene in any such proceeding, waiving and releasing all errors which may intervene in any such proceeding, and waiving and releasing all right of appeal and right to writ of error, and consenting to immediate execution upon such judgment. If there be more than one Tenant this warrant of attorney is given jointly and severally, and shall authorize the entry of appearance of, waiver of issuance of process and trial by jury by and confession of judgment against any one or more of such Tenants, and shall authorize the performance of every other act in the name of and on behalf of any one or more of such Tenants, and Tenant hereby confirms all that said attorney may lawfully do by the virtue. . .

Payment of Fees

11. Each party will pay and discharge all reasonable costs, attorney's fees and expenses that may be incurred by the other party, in enforcing the covenants and agreements of this lease, and this lease and all covenants and agreements herein contained shall be binding upon, apply, and inure to their respective heirs, executors, successors, administrators, and assigns of all parties to this lease.

Utilities; Liens

12. Tenant shall pay promptly all charges for municipal or public utility services to, in, or upon the demised premises, and shall pay promptly for garbage and waste

removal, if any, and shall pay promptly all bills for material furnished or labor performed by Tenant, or at Tenant's instance and request, in connection with any repairs, alterations, improvement, decorating, or installation of fixtures and equipment on the demised premises, and keep said demised premises free from all claims for liens for work, labor or materials, on account thereof.

Taxes

13. The Landlord shall be responsible for and pay all real estate taxes levied upon the demised premises. The Landlord shall be responsible for all personal property taxes upon the equipment installed by it. In the event of any litigation between the parties hereto, the losing party shall, in addition to any judgment entered, pay all costs and attorney's fees incurred by the other party.

Landscaping

14. Landlord shall provide and pay for the initial landscaping of the premises herein demised and the Tenant shall be responsible to pay for all maintenance upkeep of the landscaping.

Liability and Liability Insurance

15. Tenant shall save and hold Landlord free and harmless from all claims, damages, suits, or causes of action including all legal costs of defense and any and all costs resulting from injuries or damage to persons or property and arising or claims arising thereon or out of the use, occupancy, or condition of the leased premises, except as are covered by Landlord's fire and extended insurance, and Tenant shall carry, maintain and deposit proof annually with Landlord of public liability insurance with reputable companies insuring Tenant and naming

Landlord as certificate holder/additional insured, as their interest may appear, against liability in the minimum amount of Five Hundred Thousand Dollars ($500,000) to any one person and One Million Dollars ($1,000,000) for any one accident arising in or about the leased premises. The insurance limits and coverages may vary from time to time. Landlord agrees to give 30 days written notice of any and all changes in the insurance requirements to Tenant. Tenant agrees to make any and all changes in the insurance requirements, at Tenant's sole expenses upon receipt of the notice of change from Landlord.

Tenant agrees to all provisions of the Lease for the protection of the premises, all protection from liability shall inure to the benefit of Bill Anest and Peter Anest d/b/a S & S Petroleum Products and State Oil Company. Tenant shall supply Landlord with a Certificate of Insurance within 30 days of the signing of this agreement and annually thereafter.

Liquor License and Insurance

16. Tenant agrees, that in the event Landlord is able to assign or obtain the assignment of a liquor license, Tenant will reimburse Landlord for any and all expenses, fees, etc., incurred by Landlord to obtain said liquor license. It is further understood and agreed between the parties hereto that in the event a liquor license is issued to Tenant for the operation of a convenience store at the premises demised herein that license shall be utilized only in connection with said premises and that in the event of a termination of this lease for any reason Tenant agrees that he will assign all interest in said license to Landlord, and will release any right or interest which Tenant may have therein, and will direct

the licensing agent to reissue said license in the names of Landlord or their nominees. Tenant further agrees, that to the extent possible, this paragraph shall constitute such an assignment and direction effective upon the termination of this lease, Tenant understands that any attempt to transfer said license to a different location will cause irreparable damage to Landlord, which damage is not capable of accurate determination; and they do hereby consent, in the event of any attempt to transfer said license without the approval of Landlord, to the immediate issuance of a restraining order by any court of record, without notice to Tenant, forbidding the transfer of said license. That Tenant will provide Landlord with liquor liability insurance paid six months in advance.

Fire and Extended Coverage

17. Landlord shall procure and maintain at its own expense during the term of this lease, fire, windstorm and extended coverage insurance on the leased premises.

SALE OF PREMISES

18. In the event of any sale of the premises by Landlord (or S & S Petroleum Products) during the term of this lease, Tenant shall have a right of first refusal to purchase the premises at the same terms and conditions as those at which Landlord proposes to sell. This right shall be deemed to have been waived, unless Tenant shall notify Landlord or his election to proceed with such purchase within 30 days of the date of receipt by Tenant of a copy of Landlord's proposed sale agreement. This right shall not accrue to an assignee of this lease.

Condemnation

19. If all or part of the leased premises are taken or condemned for public purposes by public authorities

(whether by judicial action or settlement arising out of negotiation), the award shall be made to Landlord. In the event such of the parking area or leased premises are taken by condemnation as renders it impracticable or impossible for Tenant to carry on its business, or in any event if more than thirty percent (30%) of the square footage of the parking lot or leased premises is taken, Tenant may cancel and terminate this lease upon thirty (30) days written notice to Landlord. Such notice may only be given before the condemnation proceedings is tried, the settlement is reduced to writing, or Tenant is required to vacate the premises, whichever occurs first, and the term of this lease shall end as of the date of condemnation award is paid to Landlord and accepted by it in full and final settlement of all claims, or Tenant is required to vacate whichever occurs first. In no event shall Tenant be liable for rent after having vacated the premises according to law. If this lease is not so terminated, rent shall abate in proportion to the amount of floor area condemned, as of the date the floor area shall become unavailable to Tenant, and Landlord shall at its expenses restore the remaining area in tenantable condition.

Cancellation of Lease

20. Tenant shall have the right to cancel this lease by giving Landlord Ninety (90) days written notice by Certified Mail. In the event Landlord shall, at any time during the term of this lease, elect to sell the premises leased hereunder, the Landlord shall be entitled to terminate the lease upon notice to Tenant accompanied by an offer to sell to the Tenant, the premises being sold at the same terms and conditions as those on which the Landlord proposes to sell. Landlord may make any and

all modifications in all agreements that are set forth or may terminate this lease by giving Tenant thirty (30) days written notice by Certified Mail. If the Landlord shall enter into a lease agreement with a different supplier, the Tenant agrees to enter into a new lease and supply agreement upon the terms provided by that supplier.

Purchase of Inventory and Equipment Upon Termination

21. In the event this Lease is terminate by the Tenant, then the Landlord may purchase from the Tenant all store merchandise and gasoline inventory at the Tenant's actual cost. The amount of purchase shall be due and payable on the date that the Tenant vacates the demised premises subject to the uniform commercial code requirement and any outstanding indebtedness to Landlord.

Any and all equipment installed or replace by Tenant shall become a permanent fixture and shall remain in the building and become the property of the Landlord at the expiration of this Lease.

Subordination to Underlying Lease

22. This Lease is subordinate to any underlying lease now, or hereinafter, in effect between Landlord and its lessor. Landlord is under no obligation to extend or renew such underlying lease. In the event of termination or cancellation thereof, this Lease shall terminate automatically, without liability on Landlord's part.

Assignment

23. Tenant shall not assign this lease or gasoline supply agreement without prior written consent of Landlord, but such consent shall not be unreasonably with-

held. Landlord's consent to one assignment shall not be deemed a consent of any other or further assignment.

Covenant to Bind Successors

24. It is agreed that the provisions, covenants and conditions of this lease shall bind and inure to the benefit of the legal representative, successors and assigns of the respective parties hereto.

General Provisions

25. Nothing contained in this lease shall be deemed or construed by the parties hereto or by a third party to cheat the relationship of principal and agent or of partnership or of joint venture or of any association whatsoever between Landlord and Tenant, it being expressly understood and agreed that neither the method of computation or rent nor any other provisions contained in this lease nor any act or acts of the parties hereto, shall be deemed to create any relationship of Landlord and Tenant.

Improvements

26. Tenant shall not make any improvements or modifications to the premises without prior written consent by the Landlord. Any and all improvements made by the Tenant will become the property of the Landlord.

Landlord reserves the right to make any additional improvements to the premises.

Upon completion of any improvements by the Landlord, Landlord will have the right to adjust the monthly rental for any such improvements.

Remodeling of Premises

27. In the event that Landlord elects to remodel said premises for whatever purpose, during the term of this

lease, Landlord shall have the right to cancel this lease by giving Tenant Thirty (30) days written notice by Certified Mail. Tenant shall have the right of first refusal to enter into any new lease agreement at the terms and conditions as set down by Landlord. This right shall be deemed to have been waived, unless Tenant shall notify Landlord or his election to proceed with such Lease within 20 days of the date of receipt by Tenant of a copy of Landlord's proposed lease agreement. This right shall not accrue to an assignee of this lease.

Public Telephones

28. All public telephones are provided for and controlled by Landlord and Tenant has no financial claim.

Equipment Repairs and Maintenance

29. The Landlord shall provide all gasoline dispensing equipment, readout consoles in the store and underground storage tanks. The Landlord shall be responsible for the maintenance of all gasoline dispensing and electronic read-out equipment except damages. Landlord will repair, except for damages cause by negligence or deliberate acts by Tenant or any other person: The roof, driveway, canopy, underground storage tanks and piping, islands, weight bearing structural damage, and all exterior lighting, excluding cleaning and lambing.

The Tenant shall be responsible for the maintenance and repair of all other equipment and improvements. Tenant shall be entitled to all warranties available to Landlord upon the installation of the original equipment (see equipment list attached). The Tenant shall also be responsible for the replacement and condition of all hoses and nozzles.

Identification of Business

30. The Landlord shall be responsible for supplying and maintaining all signs and advertising relating to the gasoline brand being dispensed from the demised premises. In the event, the Tenant desires to use another name to identify the convenience grocery operation upon the demised premises, the name will be mutually agreed upon by both the Landlord and Tenant. The Landlord reserves the right to change the brands of gasoline at anytime.

Petroleum Products Supply Agreement

31. The Landlord shall furnish to the Tenant a supply of gasoline reasonable for its sales need, to the degree possible and the Tenant shall purchase its gasoline supply exclusively from the Landlord. The Landlord shall make reasonable efforts to provide an adequate supply. If the Landlord is unable to supply the Tenant's reasonable needs of gasoline, and if the Tenant shall be able to acquire a supply of gasoline from any other source, Tenant agrees to enable the Landlord to purchase that gasoline for resale to Tenant at the cost and terms available to Tenant.

In order to assist in maintaining the competitive position of both Landlord and Tenant, the Landlord will from time to time establish a recommended retail pump price for each type of gasoline sold at the location. The Landlord shall charge the Tenant for each transport of gasoline at the recommended retail pump price less margin and sales tax. The Tenant's margin will be $0.0325 (three and ¼ cents) per gallon. In the event the Tenant elects to sell at retail at a price in excess of the recommended retail pump price established by the Landlord,

the Tenant shall pay the Landlord a sum equal to the difference between the retail pump price at which the gasoline in questions has been sold, and the recommended retail pump price established by the Landlord, the Tenant shall not be entitled to a reduction in price to cover the difference. State sales tax shall be the sole responsibility of the Tenant.

The Tenant shall pay, per gasoline supply agreement, for any gasoline located in the underground storage tanks on the date of the commencement of the term of this lease. Payment terms for all future transport deliveries of gasoline at the demised premises will be paid at the time of deliver.

Tenant agrees to purchase all petroleum products from Landlord; Tenant is responsible for the purchase and payment of all signs and advertisement material. Pump hoses and nozzles will be the responsibility of Tenant. Tenant is to purchase such items from Landlord at competitive market prices.

(A) Grade. Gasolines shall be Landlord's regular commercial grades generally offered to Landlord's customers for similar use and sale at time and geographical region (which is Lake, Cook, Kane, McHenry, Dupage, Kendall, Will & all other Counties in Illinois) of delivery. Landlord reserves the right to change or discontinue, from time to time, any such brands or grades.

(B) Delivery. Deliveries of said gasolines shall be made by Landlord on Tenant's order in single deliveries of not less than 7,500 gallons. Landlord shall be required to make deliveries within 48 hours following receipt of Tenant's order but need not make such deliveries outside of normal business hours or on Sunday or holidays.

(C) Liabilities. The obligation of the parties to deliver and receive gasolines hereunder shall be suspended and excused (a) if Landlord is prevented from or delayed in producing, manufacturing, transporting or delivering its normal manner any gasoline hereunder or the materials from which such gasoline is manufactured because of acts of God, earthquake, fire, flood or the elements, malicious mischief, riots, strikes, lockouts, boycotts, picketing, labor disputes or disturbance, compliance with any directive, order or regulation of any governmental authority or representative thereof acting under claim or color of authority; or (b) loss or shortage of any gasoline due to reasons beyond Landlord's reasonable control; or (c) loss or shortage of any part of Landlord's own or customary transportation or delivery facilities due to reasons beyond Landlord's reasonable control; or (d) for any reason beyond Landlord's or Tenant's reasonable control. Whenever such causes, in Landlord's judgement, require restriction of deliveries, Landlord reserves the right, in its discretion, to restrict deliveries to Tenant, whether or not delivering to others.

(D) Payments. All sums paid to Landlord shall be paid in lawful money of the United States of America without discount at time of delivery or upon such other terms as Landlord may from time to time require. All sums paid shall be applied first to the payments of any outstanding obligation for product purchases, credit card charge backs, and/or repairs including all bills due to Landlord, with the balance being applied to payments on the Store Lease executed contemporaneously herewith.

(E) Resale Provision. Tenant agrees to resell all gasolines herein provided only under Landlord's brands or authorized brands, and to maintain Landlord's brands

or authorized brands, trade-marks and names on the pumps and other facilities through which said gasolines are dispensed. Tenant agrees not to mix, substitute or adulterate said gasolines with any other gasolines or materials. The primary business activity of Landlord is the sale and distribution of petroleum products and is the understanding of the Landlord and Tenant that the Tenant will continue during the term of this agreement to purchase all petroleum products at this location from the Landlord. In the event the Tenant mixes, substitutes, or adulterates said petroleum products, or at Landlord's option, this lease may be terminated upon 5 (five) days written notice to tenant. The Tenant understands this paragraph in its entirety and upon signing of the lease is in complete agreement with all of the above.

(F) Notice. Any payments, requests or notice required or permitted to be given hereunder to Tenant shall be deemed properly given and served when deposited, postage prepaid, Registered or Certified, in the United States mail address to Tenant at his place of business specified above or, in lieu of such demands, request or notices may be personally served upon Tenant. Any notices hereunder required or permitted to be given to Landlord shall be deemed properly given and served when deposited, postage prepaid, Registered or Certified, in the United States mail addressed to Landlord at 400 S. Curran Road, Grayslake, Illinois 60030.

(G) Modification. This lease may be modified of superseded by any and all governmental laws and regulations enacted subsequent hereto pertaining to Energy Allocation and Conservation; however, hardships and forfeitures shall not be enforced between parties as a result.

(H) Tenant's Assignment. This lease and supply agreement shall not be assigned by Tenant or by operation of Law without Landlord's prior written consent, which shall not be unreasonably withheld, but otherwise shall be binding upon and shall inure to the benefit of the parties, and heirs, their representatives, successors and assigns.

Credit Cards

32. The Tenant shall have the option of accepting credit cards for retail gasoline sales. If a nationally-branded gasoline product is being advertised and sold from the demised premises, and if the major oil company whose brand is being used required that its credit cards be accepted, then the Tenant shall accept such credit cards and shall comply with all credit card regulations of supplying company. All fees, discounts or charges including charge-backs associated with the use of the credit card will be at the sole expenses of the Tenant,.

Meter Readings and Inventory Control

33. Landlord reserves the right, at their option, to have a representative audit the meter readings at the beginning of any given month to verify purchases against sales. Inventory control is required because of the pollution insurance on all underground storage tanks. Tenant agrees to take stick readings and pump readings on every day of each month and mail the inventory control forms and tank data sheets to State Oil Company, 400 S. Curran Road, Grayslake, Illinois 60030, on or before the 5th day of the following month.

Sales Tax Affidavit

34. Tenant agrees to provide Landlord with a signed sales tax affidavit.

Paragraph Headings

35. The paragraph titles herein are for convenience only and do not define, limit, or construe the contents of such paragraphs.

Representations

36. U. Khan (Bob) Barkat has made his own investigation concerning the demised premises and the business conducted thereon and is not entering into this transaction because of any statement, representation or warranty by State Oil Company or any one on their behalf except as stated below:

The tenant understands that although he is taking over a going business, there are certain risks involved in running any business, and to a great degree the success of the business will depend on the effort and judgement of the tenant. As with any business there is a definite risk of loss. The tenant hereby assures State Oil Company that he is financially able to incur any risk of loss which exists particularly if geographical or economic conditions change or if the operation of the business does not meet the necessary standards.

RECEIPT OF NOTICE

37. I (we) have received a copy of the SUMMARY OF THE PETROLEUM MARKETING PRACTICES ACT, #3128-01-Federal Register-Vol. 43, No. 169, which is made part of my lease with STATE OIL COMPANY.

IN WITNESS WHEREOF, the parties hereunto have caused this lease to be executed, in Grayslake, Illinois, this 6th day of January, 19 92.

LANDLORD: STATE OIL COMPANY

By:_____
Peter Anest, President

OR

/S/_____
Bill Anest, Secretary/Treasurer

TENANT:

By: /S/_____
U. Khan (Bob) Barkat

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

BARKAT U. KHAN and KHAN & ASSOCIATES, INC., an Illinois Corporation,	)	
Plaintiff,	)	JURY TRIAL DEMANDED
vs.	)	Gen. No.
STATE OIL COMPANY, a corporation,	)	
Defendants.	)	

DECLARATION OF
GUSTAVO E. BAMBERGER, Ph.D.,
IN SUPPORT OF MEMORANDUM IN
OPPOSITION TO OBJECTION
AND MOTION TO STRIKE

Gustavo E. Bamberger, Ph.D., on oath, deposes and states that if called to testify in this matter he could competently testify to the following based on his personal knowledge:

1. He is Vice President and Senior Economist at Lexecon Inc., 332 South Michigan Avenue, Suite 1300, Chicago, Illinois 60604.

2. A copy of Dr. Bamberger's expert witness report prepared in the above-captioned case (the Report") is attached hereto as Exhibit A.

3. Copies of the document that Dr. Bamberger utilized in preparing his Report are attached hereto as Group Exhibit B.

4. Documents No. 1 through 6 of Group Exhibit B were generated by Dr. Bamberger at his office based on various data gleaned from Documents No. 7 through 12.

5. For example, Document No. 3, which reflects the Receiver's Average Margin Per Gallon during May-September, 1993, was generated by calculating the overall gasoline margin for that same period (by subtracting the cost of goods sold from the sales figures contained in Document No. 10), and then by dividing that number by the gallonage sales for that same period (contained in Document No. 7). The result is approximately .038, a margin per gallon higher than the margin dictated by the parties agreement, which was .0325.

6. Document No. 7 is a true and correct copy of a letter received by Dr. Bamberger from Barkat U. Khan dated June 8, 1994.

7. Document No. 8 is a true and correct copy of Illinois Department of Revenue correspondence and data received by Dr. Bamberger from Denise M. Kaplan, Esq., counsel for plaintiffs.

8. Document No. 9 is a true and correct copy of a letter received by Dr. Bamberger from Barkat U. Khan dated February 14, 1995.

9. Document No. 10 is a true and correct copy of Addison 76 Receivership Income Statements for February, 1993 through September, 1993 received by Dr. Bamberger from Barkat U. Khan.

10. Document No. 11 is a true and correct copy of Khan & Associates, Inc.'s U.S. Corporation Income Tax Return for 1992 received by Dr. Bamberger from Barkat U. Khan.

11. Document No. 12 is a true and correct copy of the relevant Consumer Price Index from the Economic Report of the President of the United States, 1995.

12. In addition to the review of the above-referenced document, Dr. Bamberger also met with Barkat U. Khan, Champ W. Davis, Esq., the late David C. Bogan, Esq., and Denise M. Kaplan, Esq. He also spoke with the Receiver's Manager, Timothy McNally.

13. Based on the above, Dr. Bamberger swears that the Report contains his truthful and accurate opinion of plaintiffs' damages in this case.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on July 7, 1995.

Gustavo E. Bamberger,
Ph.D.

REPORT OF GUSTAVO E. BAMBERGER

1. My name is Gustavo E. Bamberger. I am a Vice President and Senior Economist at Lexecon Inc., an economics consulting firm that specializes in the application of economic analysis to legal and regulatory issues. I received a B.A. degree from Southwestern at Memphis and M.B.A. and Ph.D. degrees from the University of Chicago. I have served as an expert witness in U.S. Federal Courts, before the Illinois Commerce Commission, and in an arbitration proceedings, and I have submitted testimony to the U.S. Senate. My Curriculum Vita, including a listing of my previous testimony, is attached as Exhibit A. Lexecon bills for my time at a rate of $290 per hour, plus expenses.

2. I have been asked by counsel for Barkat U. Khan and Khan & Associates, Inc. ("Khan") to estimate the gross dollar margin (i.e., revenue less cost of goods sold) that Khan could have earned on gasoline and ancillary (e.g., groceries, cigarettes, pop) sales if he had been allowed to set retail prices of gasoline without the constraints imposed by the State Oil Company ("State Oil"). Khan's service station/convenience store was located in DuPage county and was operated under a three year lease/supply agreement with State Oil which was entered into on approximately January 20, 1992. Khan operated the station until approximately February 8, 1993, at which time its operation was taken over by a Receiver, who remained in control of the station until approximately September 7, 1993.

3. In my opinion, Khan could have earned gross dollar margins of $212,996 in 1992, $211,092 in 1993, and

$216,580 in 1994.[1] I understand that Khan's actual gross dollar margin on gasoline and ancillary sales in 1992 was $183,621. Thus, the constraints imposed on Khan by State Oil reduced Khan's profits by $29,375 in 1992 (i.e. $212,996 less $183,621).

4. Under the terms of his contract with State Oil, Khan's gross dollar margin could be at most $0.0325 per gallon and could be zero or a loss if Khan lowered prices below State Oil's posted retail prices. Any additional per gallon margin received from sales of gasoline sold at prices above the posted price was to be paid to State Oil under the terms of the lease. It is Khan's position that he could have increased his business's total gross margin by increasing the per gallon margins he received on premium grades of gasoline (i.e., by charging more than the State Oil posted price and being allowed to keep the entire per gallon margin) and reducing per gallon margins on regular gasoline.

5. I understand that, beginning about May 1, 1993, the Receiver stopped adhering to State Oil's posted retail prices and increased per gallon margins on premium and mid-grade gasoline and reduced the per gallon margin on regular gasoline. I also understand that the Receiver operated the station in substantially the same way as Khan (e.g., the station's hours of operation did not change) and that competitive conditions in the immediate vicinity did not change substantially (e.g., no new gasoline station opened within a few blocks of Khan's

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[1] Because information on partial months is not available, I approximate the term of Khan's contract (January 20, 1992-January 19, 1995) by the three-year period 1992-1994.

former location; no gasoline station closed within a few blocks of Khan's former location; no substantial road work was done in front of a competitor's station).

6. I have analyzed the Receiver's experience between May and September, 1993. Based on the Receiver's experience over this period, it is my opinion that Khan could have increased his gross dollar margin if his pricing policies had not been constrained by State Oil. The difference in Khan's sales during the period May to September 1992 and the Receiver's sales in the corresponding five months in 1993 reflects the effect of the change in pricing policy that the Receiver put in place, which Khan was prevented from implementing. (The difference in 1992 and 1993 sales also may reflect, in part, changes in general economic conditions. By calculating the effect of changes in general economic conditions, I am able to isolate the effect of the change in pricing policy.)

7. During the period May-September 1993, the Receiver sold about 20.8 percent more gallons of gasoline than Khan over the corresponding period in 1992. Because the change in pricing policy increased the margin on premium gasoline and lowered the margin on regular gasoline, one would expect that the change in pricing policy would result in higher sales of regular gasoline and lower sales of premium gasoline. Therefore, regular gasoline should account for a higher percentage of total gasoline sales in 1993 than in 1992. This expectation is confirmed by comparing sales data from May-September 1992 and May-September 1993. See Table 1.

8. I estimate the effect of general economic conditions on gasoline sales at the former Khan location by assuming that absent the change in pricing policy, gallon sales at Khan's former location would have changed by the same percentage amount as total gasoline gallon sales in DuPage County. Based on records provided by the Illinois Department of Revenue, I find that total gasoline gallon sales in DuPage county were about 11.6 percent higher during May-September 1993 than during May-September 1992. The pricing flexibility utilized by the Receiver therefore resulted in increased sales of approximately 9.2 percent (i.e. a 20.8 percent increase less the 11.6 percent increase attributable to changes in general economic conditions). Thus, based on the Receiver's experience, I estimate that Khan's sales in 1992 would have been abut 9.2 percent higher if his contract with State Oil did not constrain his ability to set retail prices. Based on the Receiver's experience, I also find Khan would have been able to earn higher per gallon margins absent the restrictions of the State Oil contract—during the period May - September 1993, the receiver earned average gross margins of $0.0382 per gallon, or 17.5 percent more than State Oil-imposed maximum of $0.0325 per gallon.

9. Khan earned a gross margin of $65,173 on gasoline sales in 1992 (i.e. 2,005,317 gallons at $0.0325 per gallon). Based on the Receiver's experience, it is my opinion that Khan could have earned a gross margin of $83,651 (i.e. 2,005,317 gallons per gallon times 1.092) over the same period if his contract with State Oil did not prevent him from earing more than $0.0325 per gallon. Thus, the constraints imposed by State Oil's contract reduced Khan's gross dollar margin on gasoline by $18,478 (i.e. $83,651 less $65,173).

10. I also estimate the gross margin on ancillary sales that Khan would have earned absent the restrictions in the State Oil contract. I performed a series of regression analyses to examine whether there is a relation between ancillary sales and gasoline sales. I found that ancillary sales were statistically significantly related to gasoline sales. I also found that ancillary sales were proportional to gasoline sales. That is, I found that, for example a one percent increase in gallons sold resulted in a one percent increase in ancillary sales. Thus, because I found that Khan's gallon sales would have been about 9.2 percent higher in 1992 absent State Oil's restrictions, ancillary sales also would have been about 9.2 percent higher in 1992 if Khan's pricing policies had not been constrained.

11. Khan's gross margin on ancillary sales in 1992 was $118,448 (i.e. total gross margin of $183,621[2] less gross margin of $65,173 on gasoline sales). Based on the Receiver's experience, Khan could have earned a gross margin on ancillary sales of $129,345 (i.e., $118,448 times 1.092). Thus, the constraints imposed by State Oil's contract reduced Khan's gross dollar margin on ancillary sales by $10,897 and Khan's total gross dollar margin (gasoline and ancillary sales) by $29,375 in 1992.

12. The Receiver's total gross dollar margin for the period May - September 1993 was $89,292. The period May - September 1993 accounted for approximately 42.3 percent of DuPage County's sales of gasoline during 1993. Thus it is mu opinion that Khan's total gross dollar margin in 1993 would have been about $211,092

[2] Based on Khan's U.S. Corporation Income Tax Return for 1992.

(i.e., $89,292 divided by 0.423).[3]

13. I do not have information on the performance of the former Khan location for 1994. Assuming that there were no substantial changes in how the station was operated or in competitive conditions in the immediate vicinity, the stations dollar performance in 1994 likely would have been the same as in 1993, after adjusting for inflation.[4] Inflation during 1994 (as measured by the Consumer Price Index) was about 2.6 percent. Thus, it is my opinion that Khan's gross margin for 1994 would have been $216,580 (i.e. $211,092 times 1.026).

[3] I understand that there were no substantial changes in how the station at the former Khan location was operated or in competitive conditions in the immediate vicinity (e.g., other stations within a few blocks) through November 1993. I assume that there were no substantial changes in conditions during December 1993.

My estimate of gross dollar margin in 1993 is almost the same as in 1992 because the Receiver earned a lower percentage margin on ancillary sales than did Khan (Khan earned about 29 percent margin and the Receiver earned about 24 percent). If the Khan location had earned an average margin on ancillary sales of 29 percent during 1993, my estimate of gross dollar margin for 1993 would be understated by $26,188. Thus the total gross dollar margin for 1993 would be $237,280. Similarly, if the margin on ancillary sales were 29 percent in 1994, the total gross dollar margin would be $243,449.

[4] Total gasoline sales in DuPage county during 1994 were about 4.5 percent higher than sales during 1993. If gallon sales increased by 4.5 percent per gasoline station, on average, my estimate likely understates Khan's total gross dollar margin for 1994 by $9,746; that is, 1994's total gross dollar margin would by $226,326. If the margin on 1994 ancillary sales were 29 percent and gallon sales increased by 4.5 percent per station from 1993 levels, 1994's total gross dollar margin would be $254,404.

Dated May 30, 1995

Gustavo E. Bamberger

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS

Case Number 94 C 35 Date: September 12, 1995

Name of Assigned Judge: CHARLES R. NORGLE

Case Title: BARKAT U. KHAN and KHAN & ASSOC., INC. v. STATE OIL CO.

****

DOCKET ENTRY:

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(10) [Other docket entry]

Court rules in limine that "rule of reason" and not "per se rule" applies in this case.

Regarding final pretrial order, Attachment B, paragraph 3, the court rule in limine that the agreement will be analyzed under a "rule of reason" rather than "per se rule." The U.S. Supreme Court has held that per se rules are appropriate only for conduct that is manifestly anticompetitive, that is, conduct that would always or almost always tend to restrict competition and decrease output. "Per se rules are invoked when surrounding circumstances made the likelihood of anticompetitive conduct so great as to render unjustified further examination of the alleged conduct" *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692 (1978) (agreement per se illegal only if their nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish

their illegality). The scope of per se illegality should be narrow in the context of vertical restraints. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). The language in the franchise agreement and the submissions of counsel do not establish manifestly anticompetitive implications or pernicious effect on competition, to justify application if the "per se rule."

Supreme Court, U.S.
FILED
APR 3 1997
CLERK

No. 96-871

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN and KHAN & ASSOCIATES,
an Illinois Corporation,

Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the Seventh Circuit

BRIEF FOR PETITIONER

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29 pp

QUESTIONS PRESENTED FOR REVIEW

1. Did the court below err in holding that an agreement between a supplier and a dealer, under which the dealer's margin or markup was limited was a *per se* violation of the Sherman Act?

2. Did the court below err in holding that a gasoline dealer, who was limited to a margin of 3.25 cents per gallon, was entitled to recover damages under §4 of the Clayton Act, for losses which he claimed from his inability to increase his profit by increasing his price to consumers?

PARTIES TO THE PROCEEDING

The caption of the case contains the names of all parties to this cause.

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OPINIONS BELOW

The decision of the United States Court of Appeals for the Seventh Circuit is reported at 93 F.3d 1358. The underlying judgment of the trial court is reported at 907 F.Supp. 1202. The opinions of the District Court and the Court of Appeals are also reproduced in the Appendix to the Petition for Certiorari. The decision of the Court of Appeals appears at Pet. App. 1a, and the decision of the trial court at Pet. App. 24a.

JURISDICTION

The court of appeals entered judgment on August 29, 1996. Pet. App. 1a. This Court granted a petition for certiorari on February 18, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254. Jurisdiction in the trial court was under §4(a) of the Clayton Act (15 U.S.C. §15[a]).

STATUTORY PROVISIONS

§1 of the Sherman Act (15 U.S.C. §1)

Contracts, Combinations and Conspiracies in Restraint of Trade

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several State, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony and, on conviction thereof, shall be

punished by a fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§4(a) of the Clayton Act (15 U.S.C. §15[a])

Actions for Damages

(a) Damages; Prejudgment Interest

Except as provided in subsection (b), any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee. The court may award under this section, pursuant to a motion by such person promptly made, simple interest on actual damages for the period beginning on the date of service of such person's pleading setting forth a claim under the antitrust laws and ending on the date of judgment, or for any shorter period therein, if the court finds that the award of such interest for such period is just in the circumstances. In determining whether an award of interest under this section for any period is just in the circumstances, the court shall consider only—

(1) whether such person or the opposing party, or either party's representative, made motions or asserted claims or defenses so lacking in merit as to show that such party or representative acted intentionally for delay, or otherwise acted in bad faith;

(2) whether, in the course of the action involved, such person or the opposing party, or either party's representative, violated any applicable rule, statute, or court

order providing for sanctions for dilatory behavior or otherwise providing for expeditious proceedings; and

(3) whether such person or the opposing party, or either party's representative, engaged in conduct primarily for the purpose of delaying the litigation or increasing the cost thereof.

STATEMENT OF THE CASE

Defendant State Oil Company was the owner of a parcel of real estate improved with a gasoline station/convenience store. It was also a distributor of gasoline for major oil companies. State Oil Company entered into an agreement with the plaintiff Khan (JA 13) under which it leased the gasoline station/convenience store to him, and also agreed to sell him gasoline for resale to the public. (JA 15) That agreement provided that State Oil Company was to set a suggested retail price for each grade of gasoline, and would sell the gasoline to Khan for 3.25 cents per gallon under that suggested price. (JA 26-27) The agreement did not require Khan to sell at the suggested price. However, if he raised his price above the suggested price, he was obligated to pay all excess to State Oil.

After Khan had operated the station for a year, a receiver was appointed by a state court. That receiver operated the station for five months. Khan claimed that the receiver had charged a margin in excess of 3.25 cents per gallon during his term of operation, and that he, therefore, lost profits because he was influenced by the contract provision not to raise his price. (JA 33-42)

The District Court for the Northern District of Illinois granted summary judgment in favor of State Oil (Pet. App. 24a), holding that there was no showing by plaintiff that the provision complained of contained any anticompetitive aspect, that the damages claimed by plaintiff were not antitrust damages, and that there was no evidence that plaintiff actually suffered any injury, and that the rule of reason should be employed in any analysis. The Court of Appeals for the Seventh Circuit reversed, remanding the case to the District Court. (Pet. App. 1a)

SUMMARY OF ARGUMENT

The antitrust laws are designed to promote free competition. For this reason, certain types of activity, which have a pernicious effect on competition and lack any redeeming virtue are conclusively presumed to be unreasonable, and therefore illegal. Horizontal price fixing by competitors has been deemed illegal, *per se*. Since 1911, vertical minimum resale price maintenance has also been regarded as illegal, *per se*. In 1968, the decision in *Albrecht v. Herald Company*, 390 U.S. 145, 88 S.Ct. 869 (1968), extended the *per se* prohibition to maximum resale price maintenance.

The vertical establishment of a maximum price will rarely have an adverse effect on competition. Although there may be a degree of harm to a dealer whose pricing is limited, that harm results from the potential for a reduction in the margin between the retail price and the wholesale price. There is always a wholesale price and a maximum possible retail price. A manufacturer or wholesaler who wishes to achieve the effects described in

Albrecht can do so by merely increasing the wholesale price. In either case, however, the harm is to the dealer and not to competition.

There are potential procompetitive effects from the vertical establishment of a maximum price. Initially, retailers may be prevented from abusing a local monopoly position or even participating in a dealer cartel. In addition, manufacturers and wholesalers, who also have an interest in the market, will be able to utilize price as a means of interbrand competition, by ensuring that price reductions will not simply inure to the benefit of dealers. Wholesaler participation in the pricing process will increase competition.

The decision establishing vertical maximum price fixing as a *per se* violation is outside of the main line of antitrust authority, and the principles of *stare decisis* should not prevent reconsideration of the question involved.

One of the elements of a cause of action on the part of a private party under the antitrust laws is the existence of an antitrust injury, an injury resulting from the anticompetitive effects of defendant's actions. The establishment of maximum prices does not produce an anticompetitive effect. The plaintiff in this case has made no claim of any injury except for a loss of the ability to earn more money by charging higher prices. This is not the type of injury the antitrust laws were intended to prevent.

ARGUMENT

INTRODUCTION

In *Northern P. R. Co. v. United States*, 356 U.S. 1, 2 L.Ed.2d 545, 78 S.Ct. 514 (1958), this Court described the function of the Sherman Act and the basis for *per se* liability under that Act in the following terms:

> "The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions." 356 U.S. 1, at 4, 2 L.Ed.2d 545, at 549, 78 S.Ct. 514.
>
> However, there are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use. 356 U.S. 1, at 5, 2 L.Ed.2d 545, at 549, 78 S.Ct. 514.

A determination was made in *Albrecht v. Herald Company*, 390 U.S. 145, 88 S.Ct. 869 (1968), that vertical maximum price restraints have a pernicious effect on competition and lack any redeeming virtue, even though the defendant in that case was actually attempting to prevent the plaintiff from using a monopoly position to raise prices to consumers.

In *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 97 S.Ct. 690, 50 L.Ed.2d 701 (1977), *Matsushita Elec. Indus. Co. v. Zenith Radio*, 475 U.S. 574, 89 L.Ed.2d 538, 106 S.Ct. 1348 (1986), and *Atlantic Richfield Company v. USA Petroleum Company*, 495 U.S. 328, 110 S.Ct. 1884, at 1892 (1990), this Court held that a private party suing under §4 of the Clayton Act must establish, in addition to a violation of the antitrust laws, that it suffered an antitrust injury, an injury resulting from an anti-competitive aspect of the conduct which constituted a violation of the antitrust laws. A distinction was made, however, between a competitor and a dealer, with a reservation of the possibility that vertical maximum price limitations might cause antitrust injury to a dealer, even though it could not cause such injury to a competitor.

I.

VERTICAL MAXIMUM PRICE RESTRAINTS SHOULD BE JUDGED BY THE RULE OF REASON

A. Vertical Maximum Price Restraints are Not Anti-competitive: There are five concerns about maximum price restraints which are expressed in *Albrecht* (390 U.S. 152-153). These are (1) interference with dealer freedom; (2) the possibility that the supplier will set price too low, thereby squeezing the dealer; (3) possible restrictions on dealer services desired by customers; (4) channeling distribution to a few dealers; and (5) possibility that maximum price may be a disguised minimum price. The dealer in this case was claiming interference with his pricing freedom, and that the wholesaler incorrectly set the prices of the gasoline to be sold at the station.

The retailer was carrying three grades of gasoline. He claimed that if he had reduced the price of regular gaso-

line and increased the price of the two higher grades, he could both have sold more gasoline and earned more money. The increase in the price of the higher grades, plus the increased sales volume of regular, would have more than covered the reduction in the price of regular.

This is a claim that the wholesaler did not correctly establish the price relationship between the grades of gasoline, and that one party or the other could have made more money had the prices been established differently. This claim has nothing to do with competition. The effect on the public would have been identical if it had been the wholesaler which had reduced the wholesale price of regular to the dealer and increased the wholesale price of premium to the dealer. The wholesaler would then have earned the additional profit, but the consumer's position would have been identical. This is not a claim that the actions of the wholesaler reduced competition, it is a dispute about the profitability of various pricing strategies.

The primary concern of the antitrust laws is interbrand competition. *Business Electronics v. Sharp Electronics*, 485 U.S. 717, at 726, 99 L.Ed.2d 808, 108 S.Ct. 1515, at 1521 (1988). In most circumstances, vertical maximum price restraints would enhance interbrand competition. Retailers who for some reason were not being forced by market conditions to reduce prices to meet competition, would be forced by the restriction to reduce those prices.

Market conditions might permit higher prices because the retailer holds a local monopoly position, as in *Albrecht*, or because of a horizontal pricing agreement among local retailers. Higher prices may result from a belief on the part of the retailer, as in this case, that he

could make more money with a higher profit margin, despite a lower volume of sales.

The remaining possibilities expressed in *Albrecht* relate to the profit margin which will remain to the retailer after the maximum price is established. They are not based on the maximum price by itself, but on the relationship between the price which the retailer can charge and the price which the retailer must pay to the wholesaler. If the margin between the wholesale price and the maximum possible retail price is too small, then the retailer will be squeezed, and will be unable to provide services. He may even be forced out of business. This is true whether that maximum price is established by the market or by the wholesaler. If the wholesaler increases the price to the retailer to the point at which the market prevents the retailer from earning an adequate profit, these same effects will occur. However, a wholesaler which drives out its own retailers is injuring itself, not competition.

There is no incentive to establish a maximum price, or, as in this case, a maximum margin, unless that price is lower than the maximum price dictated by market conditions. The objective must necessarily be with sales volume. A manufacturer or wholesaler who sets both the maximum price and the wholesale price is also necessarily establishing the retailer's maximum possible profit margin.[1] If that margin is agreed upon in advance, then the primary question is merely whether the retailer made a good deal or a bad deal. If the wholesaler retains

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[1] Or, as in this case, a wholesaler who sets the wholesale price and the maximum margin is necessarily establishing the retailer's maximum price.

discretion in pricing, it will be in a position to reduce the retailer's profit margin. However, a party who retains the right to set a price is required by §2-305(2) of the Uniform Commercial Code to exercise that discretion in good faith. State Oil is not suggesting that the retailer should be deprived of a remedy, merely that antitrust is not the appropriate remedy.

There is a difference between an activity which can be used in a deliberate attempt to reduce interbrand competition, and one which cannot be so used. When a wholesaler fixes a minimum price, the retailer is deprived of the right to utilize price reduction as a means of competition. Competing retailers are then relieved of the need to meet that price competition. This is an effective means of supporting a dealer cartel, or even a cartel among wholesalers. In contrast, a maximum price limitation cannot be used to reduce interbrand competition. It may deprive an individual retailer of the ability to utilize some particular marketing technique, such as enhanced services. However, this does not represent an attempt to reduce competition, it represents a difference of opinion between the retailer and the wholesaler or manufacturer concerning the most effective means of marketing the particular product. The wholesaler and manufacturer are also entitled to opinions concerning the best means of marketing the product.

A price reduction should enhance price competition. A reduction could drive competitors out of the market. However, unless the reduction is predatory and the cost of new competitors entering the market is prohibitive, the effect on consumers will be positive. It will not be possible to produce a situation in which the wholesaler or manufacturer will ultimately be able to raise prices above the normal competitive level.

There was no evidence or claim in this case that the consumer was injured. There was no evidence or claim of predatory pricing. There was no evidence or claim that anyone other than plaintiff and defendant were affected. There was no evidence or claim that this arrangement could ever be used to affect anything other than the pricing relationship between the individual wholesaler and retailer.

B. Vertical Maximum Price Restraints Can be used to Promote Competition: Nothing in the antitrust laws, or in economic theory, establishes that any one level of the economic chain is more competitive or more capable of fostering competition than any other level. Market forces operate at each level. Competition is not limited to the retail level. Manufacturers and wholesalers also engage in price competition, although they may conduct that competition through retailers. A wholesaler attempting to attract public interest to a new product, or attempting to increase volume in order to introduce handling efficiency, must be able to insure that its price reductions to the retailer are passed on to the public.

There is no evidence that retailers are more capable of appropriately pricing items. If vertical maximum price restraints are forbidden, the manufacturer and wholesaler are denied the right, in many cases, to participate with their retailers in the use of pricing as a competitive tool, and the consumer is ultimately denied the benefit of that element in the competitive chain. Consumers are not served by a rule denying manufacturers and wholesalers the right to ensure that their products are priced

in a manner which will enhance volume of sales rather than retailer profit. The ultimate effect of *Albrecht*, is that all pricing decisions must be left to the retailer. However, the basic premise in *Albrecht* that retailers will better serve consumers when they are given freedom from any pricing constraints is incorrect. If freedom from restraints on competition is the purpose of the Sherman Act, then *Albrecht* is an aberration. That decision frees the retailer by placing restraints on the freedom of the wholesaler and manufacturer. Because of the *per se* rule, that restraint on the wholesaler and manufacturer is absolute. The defendant is not permitted to justify its actions or to show that establishing a maximum margin is pro-competitive. There is no claim in this case that the wholesaler could have had any adverse effect on competition. The claim is that State Oil restrained plaintiff's ability to earn more money. Yet, if *Albrecht*, is applied, State Oil is guilty of restraining trade.

Competitive price is not something which is exact. The minimum price is determined primarily by the cost of the item. Sales at cost will maximize volume, but will result in no profit. With each price increment, profit margin will rise and sales will drop. At some point, there is the figure at which profit margin multiplied by volume of sales will produce the maximum profit. If price is increased above that level, the drop in volume will more than eliminate the advantage of the increased margin. When the relationship between the wholesaler and the retailer comes into consideration, that price is the one at which the combined profit of the two entities is maximized. That profit must then be divided between the entities. The division will depend on the relative bargaining power of the parties.

If the base cost for the item is $8.00, and $10.00 is the price at which the combined margin and volume produces the maximum profit,[2] the actual price of the item will depend upon the degree to which sales drop off when the price is raised above that level. The incentive for each party is to increase the price to the level which will maximize its own profit.

For example, if the wholesaler sells to the retailer at $9.00, accepting a margin of $1.00 per unit, and leaving a $1.00 margin for the wholesaler, and the retailer believes that sales will drop from 100 to 60 if the price is increased to $11.00, the retailer will make more money by selling 60 units at a $2.00 profit than it will make selling 100 units at a $1.00 profit. The overall profit drops from $200.00 to $180.00, the wholesaler's profit drops from $100.00 to $60.00, but the retailer's profit increases from $100.00 to $120.00. At this point, the incentive to the wholesaler is to increase the wholesale price to $10.00. The wholesaler then earns $120.00 and the retailer earns $60.00. Either way, the consumer receives fewer items at an increased price.

It may be assumed that in a free economy, each party will act in its own best interest. This is the only assumption which can be made in considering antitrust questions. If each party decides that volume is in its best interest in the long run, there is no problem and the item will continue to sell for $10.00. If, however, either party decides to maximize profit at the expense of volume, the consumer will pay more for a reduced supply. As this

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[2] This example is taken, in part, from 8 Phillip E. Areeda, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶¶ 1635-38 (1989).

Court noted in *Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 53 L.Ed.2d 568, 97 S.Ct. 2549 (1977), note 24 at 433 U.S. 56, a manufacturer or wholesaler would generally "prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher revenues."

The responses which are presently available to the wholesaler are limited. In theory, it may be entitled to refuse to deal with retailers who charge more than a suggested price. It may be able to require the retailer to maintain a certain sales volume. It can reduce the price to the retailer, and hope that the retailer will pass this reduction on to the consumer. It can raise the wholesale price and obtain the increased profit itself.

A refusal to deal is normally not practical, and is quite possibly not available. In this particular case, the wholesaler has leased its gasoline station to the retailer. It cannot afford to refuse to sell to that retailer. It cannot reserve the right to terminate the lease unless the retailer complies with pricing mandates, without being guilty of illegal price restraints. In many situations which fall within the various acts regulating franchises, a refusal to deal is a violation of the applicable franchise act. In this case, a termination of Khan's lease would violate the Petroleum Marketing Practices Act. 15 U.S.C. 2801, *et seq.*[3]

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[3] The Petroleum Marketing Practices Act is designed to protect dealers from arbitrary terminations, and forbids termination of franchises except in specific situations. Under that statute, a franchisor might be able to terminate a dealer for failure to follow a contractually established pricing arrange-
(continued...)

It might be possible to require the retailer to meet a minimum volume requirement, thereby forcing a more competitive price. Such an agreement would be difficult to enforce except by means of termination. Termination is a remedy which is often not cost effective, and requires the wholesaler to find another outlet. In addition, a minimum sales requirement would produce serious risks to the retailer.

The wholesaler can also provide price incentives, but is unable to insure that those incentives are passed on to the consumer and are not retained by the retailer.

There are decisions such as *Acquaire v. Canada Dry Bottling Co.*, 24 F.3d 401 (2nd Cir., 1994), which indicate that the wholesaler could refuse to provide price supports or reductions to those retailers who did not pass the reduction on to the consumer.[4] An attempt by a manufacturer or wholesaler to increase sales by means of a price reduction is both competitively and economically desirable. Yet, in each of these cases, the defendant had entered into a convoluted arrangement to ensure that retailers did not merely pocket the price support which was being provided. These arrangements are necessary to avoid a claim of vertical maximum price restraints. When merchants are entering into convoluted

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[3] (...continued)
ment, if antitrust law permitted contract provisions relating to pricing. Such an arrangement would presently be forbidden by antitrust law.

[4] See also *Lewis Service Center, Inc. v. Mack Trucks, Inc.*, 714 F.2d 842 (8th Cir., 1983); *AAA Liquors, Inc. v. Joseph E. Seagram & Sons*, 705 F.2d 1203 (10th Cir., 1982); *Butera v. Sun Oil Company, Inc.*, 496 F.2d 434 (1st Cir., 1974).

arrangements in order to carry on an economically desirable activity, there is something wrong with the legal rule which mandates that arrangement.

In addition, each of those decisions is directed towards a specific promotion or particular discount. However, using the example set forth above, a wholesaler who elects to sell to the retailer for $9.00, when it could sell for $10.00, is also providing a price reduction. It would make little sense to create an exception to *Albrecht* for situations in which a special promotion was provided, yet deny that exception for the situation in which the general price was reduced in an attempt to enhance sales volume. It also would make little sense to permit convoluted schemes to achieve this purpose, yet to deny the right to carry out the purpose directly.[5]

Naturally, the majority of retailers will cooperate in promoting the combined maximum of sales and profit for both parties. However, the schemes considered in the decisions set forth above are an indication that there are significant exceptions. These exceptions normally arise when some dealers pass on the reduction, while others do not. The incentive to the wholesaler is either to engage in some circuitous arrangement to help insure a retail price reduction, or in the alternative to raise the wholesale price to a level at which the wholesaler achieves the maximum profit. Neither solution is in the best interest of consumers, retailers in general, or competition.

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[5] The indication is that if the wholesaler in this case had merely sold to the dealer at 3.25 cents per gallon under the pump price selected by the dealer, establishing a floor under which it would not go, this arrangement would have met the test set forth in *Butera*, supra.

Vertical maximum price restraints should not be considered *per se* illegal. This type of restraint by a manufacturer or wholesaler should be considered under the "rule of reason".

C. Concern for Prior Decisions Should Not Mandate *Per Se* Treatment in This Case: Certain principles about antitrust and *per se* liability were clearly enunciated In *Northern P. R. Co. v. United States*. Particular agreements or practices are presumed to be unreasonable because of their "pernicious effect on competition and lack of any redeeming virtue." 356 U.S. 1, at 5, 2 L.Ed.2d 545, at 549, 78 S.Ct. 514. Neither the practice condemned in *Albrecht*, nor the practice under consideration in this case, meet that standard. *Per se* liability for vertical maximum price restraints actually inhibits competition, because it reduces the ability of the manufacturer and wholesaler to utilize price as a means of competition.

As this Court has explained, *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736, 52 L.Ed.2d 707, 97 S.Ct. 2061 (1977); *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332, 354, 73 L.Ed.2d 48, 102 S.Ct. 2466 (1982), it is reluctant to overrule prior decisions in situations involving statutory construction. An exception exists, however, "when the intervening development of the law has 'removed or weakened the conceptual underpinning from the prior decision, or where the later law has rendered the decision irreconcilable with competing legal doctrines or policies'" *Neal v. United States*, 116 S.Ct. 763, 769 (1996), quoting *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989).

Albrecht is grounded in *United States v. Arnold, Schwinn & Co.* 388 U.S. 365, 18 L.Ed.2d 1249, 87 S.Ct. 1856 (1967), and the *per se* prohibition of vertical restraints and assumption that exclusive territorial agreements are undesirable and anticompetitive which are presented in that decision. Both *Albrecht* and *Schwinn* flow from the concept that a restraint on alienation or on the freedom of the individual retailer is an unreasonable restraint of trade. *Schwinn* was overruled in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977), and the concepts presented in that decision are not in conformity with present day approaches to antitrust law. In *Schwinn*, as in *Albrecht*, *per se* liability had been extended into an area where the rule could not be justified under the standards established in *Northern Pac. R. Co.* The decision in *Albrecht* has, if anything, received even more criticism from antitrust scholars than the decision in *Schwinn*.[6] There has been no showing that vertical maximum price restraints could have an adverse effect on competition. A number of procompetitive effects of vertical maximum price restraints have been identified.[7]

There would be no negative aspects to overruling *Albrecht*. No business has developed to make use of the principles advanced in that decision, nor have any

[6] See, for example, Easterbrook, *Maximum Price Fixing*, 48 U.Chi.L.Rev. 886 (1981). Blair and Harrison, *Rethinking Antitrust Injury*, 42 Vand. L. Rev. 1539 (1989), 8 Phillip E. Areeda, Antitrust Law: *An Analysis of Antitrust Principles and Their Application* ¶¶ 1635-38 (1989), Blair, *The Ghost of Albrecht*, 40 The Antitrust Bulletin 205 (1995).

[7] See note 13, *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 110 S.Ct. 1884 at 1894 (1990).

business strategies developed in an attempt to make a positive use of that ruling. The developments, such as vertical integration, sales quotas, and price announcements, have been directed towards avoiding the problems presented by *Albrecht*. The principles of *stare decisis* should not prevent the reconsideration and overruling of *Albrecht*.

II.

PLAINTIFF DID NOT SUFFER AN ANTITRUST INJURY

In addition to the fact that the defendant is guilty of a violation of the antitrust laws, an antitrust plaintiff must also establish that it suffered an antitrust injury. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 97 S.Ct. 690, 50 L.Ed.2d 701 (1977). In *Matsushita Elec. Indus. Co. v. Zenith Radio*, 475 U.S. 574, 89 L.Ed.2d 538, 106 S.Ct. 1348 (1986), and *Atlantic Richfield Company v. USA Petroleum Company*, 495 U.S. 328, 110 S.Ct. 1884, at 1892 (1990), this Court has made it very clear that maximum price restraints cannot generate antitrust injury.[8]

> Antitrust injury does not arise for purposes of §4 of the Clayton Act, see n. 1, *supra*, until a private party is adversely affected by an *anticompetitive* aspect of the defendant's conduct, see *Brunswick*, 429 U.S., at 487, 97 S.Ct., at 696. In the context of pricing practices, only predatory pricing has the requisite effect. See Areeda & Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88

[8] There would be an exception for effective predatory pricing, a situation which was described in *Matsushita*, supra, as extremely unlikely and difficult to achieve.

Harv. L. Rev. 697, 697-699 (1975); McGee, Predatory Pricing Revisited, 23 J. Law & Econ. 289, 292-294 (1980). Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. Hence, they cannot give rise to antitrust injury. *Atlantic Richfield Company v. USA Petroleum Company*, 495 U.S. 328, 110 S.Ct. 1884, at 1892 (1990).

It is true that this decision was rendered in an action brought by a competitor rather than by an affected retailer. In *Atlantic Richfield Company v. USA Petroleum Company*, 495 U.S. 328, 110 S.Ct. 1884, at 1895, this Court distinguished between injury to competitors and injuries to the retailers whose pricing is limited, reserving the possible anticompetitive consequences detailed in *Albrecht*, supra.

The court of appeals, in discussing the question of antitrust injury (Pet. App. 10a-11a) stated that it could not say that it was not the position of this Court that interference with the ability of a dealer to raise prices might constitute antitrust injury. In *Caribe BMW v. Bayerische Motoren Werke*, 19 F.3d 745, at 753 (1st Cir., 1994), the First Circuit read *Albrecht* as identifying three possible injuries which might constitute antitrust injury. First, the "maximum" resale price agreement might be, in reality, a disguised "minimum" resale price agreement. Second, a maximum resale price agreement might prevent a dealer from providing services and conveniences that customers would want to the point that the customers would accept the price increases needed to provide them. Third, a maximum resale price agreement might channel distribution through a few large or specifically advantaged dealers, the only ones able to earn a profit at the mandated low resale price.

The dealer in this case made no contention that any of these features existed. The allegation in the complaint was that State Oil interfered with his freedom to set his own prices. The evidence presented in response to the summary judgment motion was that he was merely unable to earn more money by charging a higher price for certain grades of gasoline. To forestall a motion for summary judgment, a non-movant plaintiff must present sufficient evidence to show the existence of each element of his case on which he will bear the burden of proof at trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). This leaves merely the possibility that this Court is of the opinion that a loss of profit to the dealer is, in itself, an antitrust injury. In no decision, however, has this Court identified mere loss of profits from increased prices as a source of antitrust injury. That designation is a misreading of *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*

There is actually little difference between the types of injury which could be incurred by competitors and the types of injury which could be incurred by dealers subject to the restraint. Each has a potential to lose profits due to an inability to raise prices. If the wholesale price paid by the rival dealer is higher, then that dealer will probably be injured. If the wholesale price paid by the rival dealer is identical, then each will merely be forced to become more competitive. This is the nature of competition. The motivation to bring suit will, however, be somewhat different. If the dealer is injured by the maximum price established, it is because market conditions were such that the dealer could have charged more to the public and the loss of sales resulting from that increase would be less than the increased margin. That is

the claim in this case. If the dealer could not have charged more to the public, then it has not been injured by the maximum price limitation. The competitor, on the other hand, is more likely to be objecting to a loss of business to the dealer who reduced prices. In essence, the dealer is more likely to file suit in consequence of an unsuccessful price reduction attempt. The competitor is more likely to file suit in consequence of a successful attempt.

Although maximum price restraints could cause an injury to a retailer, just as they could cause an injury to a competitor, they cannot cause injury to competition. The possible injuries related in *Albrecht* are identical to the injuries which could be caused to a competitor. The price established could be too low for the retailer, whether it is a competitor or restricted dealer, either to survive or to properly perform its function. There is nothing in the antitrust laws or in any decision of this Court which indicates that the dealer who is directly affected by a restriction is entitled to more protection than are competitors. This Court declined to dilute the antitrust injury requirement for the benefit of a competitor. *Atlantic Richfield Company v. USA Petroleum Company*, 495 U.S. 328, 110 S.Ct. 1884, at 1895 (1990). It should also decline to dilute that requirement for the benefit of a retailer.

CONCLUSION

Neither the actions of the Defendant in this case, nor the general aspects of the vertical establishment of maximum permitted prices, is anticompetitive. The establishment of maximum permitted prices is an attempt on the

part of the Defendant, and generally on the part of wholesalers and manufacturers to increase sales volume.

Defendant does not dispute the concept that market forces should determine what goods and services are offered, at what price those goods and services are sold, and whether particular sellers succeed or fail. Defendant is merely arguing that it should not be denied the right to enter into a contract with a retailer, which would permit the supplier to respond to those market forces. The freedom from restraints for which the retailer is arguing in this case is actually a restraint on the ability of the wholesaler to utilize price as a means of competition.

The claimed injury suffered by the Plaintiff in this case is not the result of any anticompetitive effect from Defendant's actions. There is no claim or contention that Defendant affected competition in any adverse manner. Plaintiff has not suffered an antitrust injury.

The district court correctly entered summary judgment in favor of the defendant, and that judgment should be reinstated and affirmed.

Respectfully submitted,

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(16)

No. 96-871

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN
and KHAN & ASSOCIATES, INC.,

Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the Seventh Circuit

BRIEF FOR RESPONDENTS

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QUESTIONS PRESENTED FOR REVIEW

1. Did the court below correctly hold that the imposition of vertical maximum prices by a supplier was a *per se* violation of the Sherman Act?

2. Did the court below correctly hold that a gasoline dealer which lost sales volume and profits as a direct result of the vertical price restraints imposed by its supplier suffered an antitrust injury?

PARTIES TO THE PROCEEDING

Khan & Associates, Inc., an Illinois corporation, has no parent or subsidiary companies.

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STATEMENT OF THE CASE

Defendant, State Oil Company ("State Oil"), is a distributor of gasoline products for several major oil companies including Union Oil Company ("Union").

Plaintiff, Barkat U. Khan ("Khan"), entered into a Service Station/Convenience Store Lease/Supply Agreement ("Agreement") with State Oil (JA 14-32). As part of the renewable three-year Lease Agreement for the operation of the Unocal 76 business in Addison, Illinois, Khan paid State Oil a $75,000 "origination fee" and a $25,000 "going concern fee" (JA 16).

Khan was required to purchase all of his gasoline and automotive products from State Oil and resell the gasoline under the Unocal 76 trademark (JA 26). By the terms of the Agreement, State Oil set the resale price of gasoline sold by Khan. Khan purchased that gasoline for $.0325 per gallon less than the suggested retail price (JA 26). If Khan raised his price above the suggested price, the Agreement required that any excess revenue was to be paid to State Oil (JA 26-27).

Khan paid his rent pursuant to the Agreement in a timely manner through December of 1992 (JA 36). However, he was unable to pay the rent under the Agreement in January of 1993. On January 28, 1993, State Oil served Khan with a Notice of Termination and instituted a state court proceeding to evict Khan. In that proceeding State Oil sought and obtained a court appointed receiver to operate the station. The receiver took over the operation of the station on February 9, 1993, and remained in possession of the station through October 1993 (JA 36-38).

The receiver did not follow the price restraints imposed by State Oil under the Agreement (JA 37), and obtained a margin greater than $.0325 per gallon on his aggregate gasoline sales (JA 38-39). The receiver lowered the price on regular grades of gasoline while raising the price on premium grades to the market level (JA 37). Using this approach, which was prohibited to Khan by the terms of the Agreement, the receiver increased sales volume and profit margins (JA 38-41).

The District Court held that the Agreement was not an unreasonable restraint of trade and that the injury claimed was not an antitrust injury. The Court of Appeals, in reversing, held that the Agreement constituted maximum price fixing which was *per se* illegal. *Khan v. State Oil Co.*, 93 F.3d 1358, 1360 (7th Cir. 1996). The Court of Appeals also found that the injuries claimed by Khan flowed form the anti-competitive aspects of the challenged restraint and, thereby, constituted antitrust injuries.

SUMMARY OF ARGUMENT

The antitrust laws mandate that prices are to be determined by the interplay of economic forces in the market. In furtherance of this fundamental premise of the Sherman Act, the Court has declared every attempt to interfere with the natural interplay of market forces by fixing or artificially setting price to be a naked restraint of trade. All price restraints, whether vertical or horizontal or minimum or maximum, have been condemned as *per se* illegal.

Albrecht v. Herald Co., 390 U.S. 145 (1968), is in keeping with the fundamental purpose of the antitrust laws.

By preventing a supplier from setting a maximum resale price, *Albrecht* insures that market forces will set a competitive price. Absent the *per se* ban on vertical maximum price restraints, there is a substantial risk that both price and non-price competition will be stifled. Indeed, as in this case, the maximum price restraint will result in the artificial setting of the minimum price. The Court should resist the invitation to erode the *per se* rule presented by Petitioner.

The principal reason advanced for overturning *Albrecht* is that maximum price restraints can offset the market power of retailers thereby promoting interbrand competition. This argument is premised upon the unproven and faulty assumption that retailers possess market power. Certainly this record is devoid of any evidence that Khan had market power or the intention to raise prices above competitive levels. To the contrary, Khan complained that he could not lower prices in order to maximize sales of certain products in response to market conditions. As can be seen in this case, suppliers are not always acting in the best interests of competition and the consumer.

Continued application of *Albrecht* is also justified by the principle of *stare decisis*. Congress has, for almost thirty years, left the *per se* rule in place for vertical price restraints. Any change in the application of that *per se* rule is best left to Congress.

Finally, the record reflects that Khan suffered the very injuries contemplated by the antitrust laws. Khan lost sales and profits because he could not set prices in accordance with market conditions. By restricting his margins and prices, State Oil removed Khan as an effective interbrand competitor on regular grades of gasoline. Thus, his losses are antitrust injury.

ARGUMENT

INTRODUCTION

In an unbroken line of decisions, this Court has condemned as unlawful agreements fixing prices. The illegality of price-fixing has been upheld in cases of horizontal agreements, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940), as well as vertical agreements. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). Recognizing the dangers to free competition posed by price-fixing, this Court has also declared agreements fixing either minimum or maximum prices to be unlawful naked restraints of trade. *Socony-Vacuum*, *supra*, and *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982).

This long established line of authority is grounded upon recognition that "[p]rice is the 'central nervous system of the economy' and an agreement that 'interfere[s] with the setting of price by free market forces is illegal on its face'". *National Society of Professional Engineers v. United States*, 435 U.S. 679, 692 (1978) (citations omitted). As early as *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397 (1927), this Court declared "[t]he aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition". It is therefore not surprising that this Court has consistently interpreted the Sherman Act itself as foreclosing attempts to justify price fixing. In *Socony-Vacuum*, 310 U.S. at 221-222, the Court rejected various justifications for fixing prices, including lack of market power, ruinous competition and the reasonableness of the fixed price because the Sherman Act "places all such schemes beyond the pale and protects that vital part of our economy

against any degree of interference". Consequently, the *Socony-Vacuum* Court held that any agreement "raising, depressing, fixing, pegging or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*". 310 U.S. at 223.

Opponents of the *per se* rule seek to chisel away at the *per se* illegality of price-fixing. The first blow is struck here at the *per se* ban on vertical maximum resale price maintenance announced in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). Believing this to be the vulnerable link in the *per se* rule, Petitioner argues that the conceptual groundwork of *Albrecht* has now been weakened, and that *Albrecht* should thus be overturned. But Petitioner's argument mischaracterizes the *Albrecht* rationale. *Albrecht* is founded upon the well established prohibition against price fixing, and not solely on the misperceived evils of vertical restraints of trade. Petitioner's mischaracterization of *Albrecht* is designed to divert the Court's attention from the very real threat to competition when the price setting mechanism of the market is usurped.

Even to engage in the analysis proposed by State Oil erodes the *per se* rule against price fixing. The utility of the *per se* rule lies in its inclusiveness. Under a *per se* rule, an extensive judicial inquiry is not required to analyze in minute detail each challenged price-fixing scheme to determine whether it is reasonable or unreasonable. To require, as Petitioner suggests, a case by case determination of whether the *per se* rule applies in reality does away with the rule. *Per se* rules and case-by-case determinations are mutually inconsistent. Moreover, the *per se* rule should not be abandoned merely because it condemns a practice which might be found reasonable

if a rule of reason approach were applied. *Arizona v. Maricopa County*, 457 U.S. at 345. Principles of *stare decisis* mandate that the *per se* rule not be abandoned so lightly.

In short, the position advanced by Petitioner reflects a fundamental and disturbing distrust of competition. State Oil, a marketer for Union Oil Company, maintains that market forces of supply and demand in the retail gasoline market cannot be trusted to set competitive prices. Consequently, State Oil contends that it should be permitted to impose artificial prices upon its retailers. Respondents contend, to the contrary, that granting State Oil the power to manipulate market prices to reflect the oil companies' view of the "competitive" price will invariably lead to the anti-competitive effects foreseen by this Court in the cases establishing and enforcing the *per se* ban on price fixing. This Court should not accept the invitation to start down the road to the abolition of the *per se* rule.

I.

VERTICAL MAXIMUM PRICE RESTRAINTS SHOULD REMAIN PER SE ILLEGAL

A. Vertical Maximum Price Restraints Are Anti-Competitive.

In *Albrecht*, this Court announced that vertical maximum price restraints are *per se* illegal. In the almost thirty years since *Albrecht*, the *per se* ban on vertical maximum price restraints, although criticized by commentators, has remained the law. Certainly, if *Albrecht* had abolished a pro-competitive practice, the ill effects of

that decision would have been felt in some market by now. Yet, aside from theoretical criticisms of *Albrecht*, Petitioner has offered no evidence that the *per se* ban on vertical maximum price restraints has distorted competition in any market. Absent proof of an actual effect on competition, this Court should not discard the *per se* ban on vertical maximum price restraints. Academic and theoretical concerns unsupported by demonstrated harm to competition do not warrant this drastic re-interpretation of the Sherman Act. Overturning *Albrecht* ought to require persuasive, expert testimony establishing that the *per se* rule has distorted the market. But Petitioner has presented no evidence on this critical point at all. The evidentiary record, and not economic theory unsupported by the record, is what this Court should properly consider. *Eastman Kodak v. Image Technical Services Inc.*, 504 U.S. 451, 467 (1992).

The anti-competitive nature of vertical maximum price restraints was detailed by the *Albrecht* Court. The principal vice of these schemes is that the judgment of the seller is substituted for the market forces of competition impeding "the ability of buyers to compete and survive". 390 U.S. at 152. The effects of this market distortion range from limiting the ability of dealers to furnish services to having the scheme "acquire all the attributes of an arrangement fixing minimum prices". 390 U.S. at 153.

Of particular importance in this case is the *Albrecht* Court's warning that maximum prices can become the minimum price when a dealer's margins are low. In such a case the constrained dealer lacks the ability to profitably charge less than the maximum price resulting in that price becoming, in actuality, the minimum price.

That risk is enhanced where, as here, the supplier not only sets the price but sets the dealer's margin. Faced with such a constraint on margins, a dealer could not profitably reduce prices when competition dictated.

The factual record in this case establishes the existence of these anti-competitive results. As the Petitioner concedes, it set the maximum price at which Khan was allowed to sell by setting both the wholesale price and the maximum margin at which Khan could sell gasoline (Petitioner's Brief at p. 9 fn. 1). Specifically, State Oil set the suggested retail price for regular gasoline above market levels. With almost no margin, Khan was prevented from setting prices according to market conditions. Not only could he not increase prices on premium grades of gasoline to market levels, he could not lower prices on regular gasoline to competitive levels, without suffering a monetary loss.[1] Consequently, Khan was removed as an effective interbrand competitor on regular gasoline. Given these constraints, Khan could neither increase his sales volume nor his profit margin and he was forced to default on his lease with State Oil and go out of business.

[1] The record establishes that Khan could have lowered prices on regular gasoline to gain sales while subsidizing the decreased margin by higher prices on premium grades (JA 38). The benefit of increasing premium prices and reducing the price of regular gasoline was established by the experience of the receiver who operated the station at a profit and with greater sales volume after Khan defaulted on his lease with State Oil.

Ignoring the factual record, State Oil attempts to cloak itself with the mantle of competition.[2] Espousing consumer benefit, State Oil suggests that its maximum price restraint created no adverse effect on competition because the consumer did not pay a higher price than would otherwise have prevailed in the absence of that restraint. Incredibly, Petitioner makes the bald assertion that "a maximum price limitation cannot be used to reduce interbrand competition" (Petitioner's Brief at p. 10). Yet, that is exactly what happened here. Khan, because of the constraint on his margins, was eliminated as an interbrand competitor. His customers paid more than market price for regular gasoline. Indeed, freed of the margin constraint, the receiver lowered price and increased sales. That fact indicates that State Oil's price constraints lessened competition. *Albrecht* eliminates this possibility by barring all vertical maximum price restraints. As *Albrecht* recognized, it is competition and not the possibly erroneous judgment of the seller that should control market prices.

This is the very result which the *Albrecht* Court acknowledged could occur. The existence of this impact on

[2] Petitioner and the Amici supporting the reversal of *Albrecht* cite several commentators who suggest that vertical maximum price restraints do not impact competition. However, not all recent economic literature agrees that vertical maximum resale price restraints are benign. There is now a suggestion that under certain conditions vertical maximum price restraints may have the effect of increasing prices paid by the consumer. *See* O'Brien & Shaffer, *Vertical Control with Bilateral Contracts*, 23 Rand J. Econ. 299 (1992) and Perry & Besanko, *Resale Price Maintenance and Manufacturer Competition for Exclusive Dealerships*, 39 J. Indus. Econ. 517 (1991).

minimum prices and interbrand competition makes this an inappropriate case to overturn the *per se* rule, especially in light of the continued vitality of the *per se* rule in vertical minimum price restraint cases. *California Retail Liquor Dealers Ass'n. v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980).

A further consumer injury flows from maximum price fixing. By squeezing a retailer's profit margin, services may be denied to consumers. Petitioner wrongly suggests that this Court should ignore this type of an injury because it does not relate to price competition. Yet, it is quite clear that non-price competition on services is an important element of actual competition in the market place, especially in commodity-like markets. Ironically, the need to provide full service is one of the reasons generally advanced by those advocates of treating vertical restraints differently from horizontal restraints. *See Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). Certainly any scheme denying consumers the benefit of valuable services which would be available if competition remained unfettered is anti-competitive.

When stripped of its rhetoric, Petitioner's position is that maximum price fixing, whether vertical or horizontal, should not be *per se* illegal. Petitioner focuses on the lack of an impact on interbrand competition and on the alleged benefits to consumers from lower prices. These arguments apply to both horizontal and vertical restraints on maximum price. Thus, any rule which would distinguish between horizontal and vertical maximum price restraints would be artificial at best. This Court should not reopen the issue of whether maximum price fixing should be treated differently under the antitrust laws than minimum price fixing.

In *Arizona v. Maricopa County Medical Society, supra*, this Court rejected a challenge addressed to a *per se* ban on maximum price fixing. Although reviewing a horizontal agreement, the Court explained quite clearly that maximum price fixing was still *per se* illegal and "on the same legal—even if not economic—footing as agreements to fix minimum or uniform prices". 457 U.S. at 349. The Court's reasoning that "[t]he *per se* rule is 'grounded on faith in price competition as a market force [and not] on a policy of low selling prices at the price of eliminating competition'" remains persuasive. 457 U.S. at 349 (citations omitted). This Court has long recognized that competition, and not artificially set prices, will benefit consumers. In this regard, there is no distinction between a vertical agreement and a horizontal agreement.

The anti-competitive effects of vertical maximum price restraints have actually arisen in this case. This Court should not ignore this unrebutted evidence. The *per se* rule is the best way to deal with this risk in the future.

B. Vertical Maximum Price Restraints Rarely Promote Competition.

Petitioner argues that the *per se* rule should not apply to vertical price restraints because such restraints can be used to promote competition. Portraying retailers, such as Khan, as the enemies of competition and the consumer, Petitioner contends that suppliers must have the ability to impose maximum prices to prevent retailers with market power from gouging consumers. This argument has absolutely no relation to the facts here. Petitioner has presented no evidence that Khan, the operator of a single gasoline station in suburban Chicago, has the nec-

essary market power to impose monopoly prices. Further, the record contains no evidence that any retailer has such market power. Simply because Petitioner can conjure up the specter of a monopolist retailer, no matter how fanciful, is no reason to abandon the *per se* rule.

The pro-competitive aspects of vertical maximum price restrictions championed by opponents of the *per se* rule are a mere illusion. The alleged pro-competitive effects are premised upon the incorrect assumption that retailers for one reason or another are not subject to competitive market forces. Unless the retailer has market power, it would not be able to maintain prices above competitive levels for significant periods of time.

Since, as this Court has recognized in *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), retailers rarely, if ever, possess the market power necessary to impose higher than competitive prices, there is simply no need to permit the imposition of vertical maximum price restraints to protect against that remote possibility. The market forces of competition will act to limit retail prices to the appropriate levels. On the off chance that a retailer has monopoly power or is engaged in a horizontal conspiracy with other retailers, the antitrust laws would act to control that illegal conduct. These remedies are a far less drastic alternative than trusting suppliers to regulate competition at the retail level by imposing maximum prices.

Petitioner's position, while espousing the virtues of competition, seeks to avoid the interplay of market forces at every turn. Interestingly, Petitioner concedes that a maximum price restraint would only be dictated if the

supplier wished to impose a price other than the price that would prevail in the market. Instead of allowing sellers to set prices at artificial levels, this Court should allow market forces to dictate prices. Petitioner has failed to present a single compelling reason to abandon reliance on market forces to set the appropriate price.

Petitioner devotes a substantial portion of its argument to its complaint that *Albrecht* imposes limitations on a manufacturer's manner of doing business. For example, State Oil claims that it might not be able to set a volume maximizing price. Once again, Petitioner's argument is premised on the assumption that market forces will not work at all levels in the chain of distribution. Normally, these market forces will dictate a competitive price which optimizes consumer benefit in terms of supply, service and price.

It must be remembered that State Oil voluntarily opted to distribute gasoline through retailers such as Khan. It cannot now complain that this arrangement places it at a disadvantage in adopting various marketing strategies. State Oil is free to set the wholesale price to Khan. State Oil's profitability depends on its ability and willingness to set a wholesale price which is in sync with the retail market price—i.e., a price which permits Khan to maximize volume while earning a sufficient profit to remain in business. That is the risk inherent in selling through dealers. If State Oil does not wish to run that risk, it should operate its gasoline stations directly.

Petitioner would have this Court believe that Khan wished to set a price which would not maximize volume. The record totally disproves this suggestion. Khan's com-

plaint arose because he sought to maximize volume by lowering price on regular gasoline while raising prices to market levels on premium grades. Khan's expert determined that the receiver who operated the gasoline station after Khan not only increased profit margins, he increased volume by approximately twenty percent using the pricing policy which Khan would have employed (JA at 38). Certainly, such unrestrained pricing would have benefitted Khan, State Oil and the consumer. A dealer, such as Khan, is simply not the enemy of competition.

State Oil's suggestion that maximum price restraints would foster competition is particularly disingenuous given the form of price restraint imposed by State Oil. Because State Oil has chosen to set the maximum price by restricting gross margins, it has, in reality, eliminated Khan's incentive to maximize volume by lowering prices. Under this scheme, there is simply no reason for Khan to lower retail prices because any retail price discount on a particular grade will merely reduce his overall margin. If Khan were free of this restraint, he would be more willing to temporarily reduce his margin to increase volume, since he could recoup that discount at a later date. Consequently, State Oil has itself restricted Khan's ability to increase volume while remaining in business.

Any potential risk that the *per se* rule will be applied to pro-competitive vertical maximum price restraints is greatly lessened, if not eliminated, by the requirement that a plaintiff prove antitrust injury. Because a plaintiff must prove that it has suffered a loss flowing from the anti-competitive aspects of a challenged restraint, it is highly unlikely that the restraint could be pro-competitive. For example, a retailer with market power will

be unable to demonstrate, as Khan has done here, that it lost business because it could not afford to lower its prices to meet competition.[3]

This Court should not abandon the *per se* rule because State Oil made a poor business decision in severely restricting its dealer's margin. If State Oil had simply allowed competition to set the prices, Khan could have priced to maximize volume, as the receiver did.

C. Principles Of *Stare Decisis* Dictate Continued Application Of The *Per Se* Rule In Cases Of Vertical Maximum Price Restraints.

In *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977), this Court explained that considerations of *stare decisis* weigh heavily against overturning prior decisions interpreting the antitrust laws "where Congress is free to change this Court's interpretation of its legislation". Although almost thirty years have passed since *Albrecht*, Congress has not acted to alter the application of the *per se* rule to vertical maximum price restraints. In fact, Congress has affirmatively expressed its interest that vertical price restraints remain *per se* illegal.[4]

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[3] While Khan does not suggest the antitrust injury rule be used to erode the *per se* rule, the Court should find that, under any circumstances, proof of interference with market forces setting price coupled with proof of an antitrust injury is sufficient to support a presumption of illegality.

[4] With the possible exception of merger policy, there is probably no area of antitrust where Congress has displayed such an explicit and abiding intent to set policy for the courts and enforcement agencies as in the area of resale

(continued...)

While acknowledging this principle, Petitioner argues that an exception to strict application of *stare decisis* exists when the development of the law has undercut the conceptual underpinning of the prior decision or where developments have rendered the decision irreconcilable with other legal doctrines. *Neal v. United States*, 116 S.Ct. 763, 769 (1996), quoting *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989). This exception does not apply to this case.

To establish that *Albrecht* has been undercut, Petitioner argues that *Albrecht* is solely grounded upon *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), which was overruled in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). As explained above, *Albrecht* is more properly characterized as grounded upon the ban on price fixing than upon the *per se* ban on non-price vertical restraints. Because *GTE Sylvania* is a vertical non-price restraint case, it has not undercut the conceptual underpinnings of *Albrecht* related to protection of competitive pricing. In fact, since this Court has continued to recognize the *per se* ban on vertical minimum price restraints, the *Albrecht* concern that maxi-

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[4] (...continued)

> price maintenance . . . . Following the *Dr. Miles* decision in 1911, Congress has revisited the area of resale price maintenance regularly—almost in clockwork 20-year cycles—with special attention to the empirical effects of the policy on consumers and interstate commerce. However, it has only been in the past 6 years that Congress has been compelled to take numerous legislative steps to ensure that the *per se* prohibition against resale price maintenance would not be eviscerated by the very officials whose sworn duty it is to enforce the laws.

H.R. Rep. No. 237, 102d Cong., 1st Sess. 4 (1991).

mum price restraints will become minimum price restraints remains conceptually sound. *See, e.g., California Retail Liquor Dealers Ass'n. v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980).

Petitioner's suggestion that the *Albrecht* should be overturned because it is wrongly decided is not enough to overcome *stare decisis*. This Court has on two occasions refused to overturn the rule that baseball is not so involved in interstate commerce as to be covered by the antitrust laws. *Toolson v. New York Yankees, Inc.*, 346 U.S. 356, 357 (1953) (*per curiam*) and *Flood v. Kuhn*, 407 U.S. 258 (1972). This Court deferred to the "positive inaction" of Congress. *Flood*, 407 U.S. at 283-84.

In an apparent attempt to distinguish *Toolson* and *Flood*, although uncited in Petitioner's brief, State Oil again, with no support in the record, suggests that businesses have not taken advantage of the *per se* rule against vertical maximum price restraints. To the contrary, since *Albrecht*, substantial investments have been made by distributors, dealers and franchisees in various businesses in reliance on their freedom to price in relation to market conditions. These investment decisions were made in anticipation that a fair return on investment could be earned through competitive pricing. For example, Khan invested over $100,000 to obtain the right to do business as a Union 76 dealer. A reversal of *Albrecht* would subject these businesses to the possible imposition of price and margin restraints which have previously been illegal. This Court must ask itself whether these investments would have been made if maximum margins could be restricted. It must be remembered that Khan could not shop around for lower priced gasoline. He was required to deal exclusively with State Oil. The

loss of Khan's sizeable investment provides a practical reason for applying *stare decisis* in this case.

II.

KHAN SUFFERED AN ANTITRUST INJURY

There can be no question that a plaintiff must establish antitrust injury even in *per se* cases. *Atlantic Richfield Company v. USA Petroleum Company*, 495 U.S. 328 (1990). Antitrust injury is an injury of a type for which the antitrust laws provide relief and which flows from the characteristic that makes a defendant's conduct unlawful. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977). However, the antitrust injury requirement should not be applied so as to eliminate the *per se* rule.

In determining whether Khan has suffered an antitrust injury, it is necessary to identify whether his injury is related to an anti-competitive aspect of the vertical maximum price restraint under scrutiny. This Court has already specifically identified the antitrust injuries flowing from vertical maximum price restraints. In *Albrecht* and *Atlantic Richfield* the Court identified the antitrust injury as related to the bound buyer's ability to compete and survive in the market. *See Atlantic Richfield*, 495 U.S. at 335. Specifically, as noted above, one anti-competitive element of such a scheme is that the maximum price tends to become the minimum price when the maximum price approaches actual cost. Thus, the antitrust injury for a retailer subject to a maximum price restraint is, as here, a restriction on its ability to profitability compete. *See also*, *Caribe BMW, Inc. v. Bay-*

erische Motoren Werke Aktiengellschaft, 19 F.3d 745, 753 (1st Cir. 1994).

The losses suffered by Khan are exactly the type of losses that flow from the anti-competitive aspects of a vertical maximum price restraint that has become a minimum price restraint. First, Khan could not profitably compete on regular gasoline. The suggested pump price of regular gasoline set by State Oil was higher than the prevailing market rate. Thus, the wholesale price ($.0325 less than the suggested pump price) did not leave Khan sufficient margin to meet these prices. Khan could either meet the market price to maximize volume at a loss or he would lose volume. In either case, Khan was put at a serious disadvantage.

Second, Khan lost profits because he could not increase his prices on premium gasoline to offset losses on regular gasoline. The direct result of the price restraint was to prevent Khan from raising the price for premium grades to market levels. Finally, caught in this profit squeeze, Khan went into default and lost his business.

Petitioner, in order to argue that Khan suffered no antitrust injury, is forced to distort the record by ignoring the crux of Khan's claim and evidence. Petitioner suggests that Khan did not claim that the maximum price had become the minimum price. This is simply untrue. Khan specifically argued in the lower court that the margin restraint prevented him from lowering price on regular gasoline with a resulting loss of business. In fact, Khan's expert, whose opinions were unrebutted, specifically declared that the removal of the price restraints by the receiver resulted in lower prices and margins on regular gasoline with a corresponding greater

sales volume (JA 38 at ¶6-7). The receiver was able to offset the lower prices and margins on regular gasoline by raising prices on premium grades to market levels (JA 38 at ¶6-7). All of this was accomplished with an overall volume gain of twenty and eight-tenths percent (20.8%) (JA 38 at ¶7).

These findings undoubtedly show antitrust injury. Khan lost sales volume because he could not operate his business in the manner best suited to maximize volume. Khan lost profits because he was forced to sell premium gasoline at below market levels while being forced to forego offering a competitive price on regular gasoline. In the absence of the challenged price restraint, Khan would not have suffered these losses.

Petitioner argues that *Atlantic Richfield* holds that such losses are not antitrust injury. This argument misconstrues *Atlantic Richfield*. There, the Court dealt with the definition of antitrust injury in the context of a complaining competitor and not that of the bound dealer. Those positions are inherently different. A dealer which has its margins restricted so that it cannot lower prices to meet competitive conditions suffers an injury that a competitor does not. That is precisely what happened here. Khan was prevented from competing on regular grades of gasoline because of margin limitations. He lost sales volume and profits. That loss is antitrust injury.[5]

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[5] Petitioner relies on the Seventh Circuit Opinion to suggest that losses suffered by a constrained buyer's inability to raise prices may not be antitrust injury. This position, however, conflicts with the Seventh Circuit decision in *Slowiak v. Land O'Lakes, Inc.*, 987 F.2d 1293 (7th Cir. 1993).

CONCLUSION

For the foregoing reasons, the decision of the court below should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN and KHAN & ASSOCIATES, an Illinois Corporation,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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SUMMARY OF ARGUMENT

Respondent has exaggerated Petitioner's position, and has also based his argument on factual assertions which are not supported by the record. Although Respondent does point out some business concerns which might exist in the franchising field, the effect of the antitrust laws extends far beyond franchising.

The Respondent's argument that maximum prices could become minimum prices is based on a consideration of two separate products as though they were the same item. Petitioner's primary argument that there is no reason to deny manufacturers and wholesalers a right to participate is ignored.

The proposed legislation which was being considered in the statements cited by Respondent provided only for horizontal price fixing, and would have excluded vertical maximum price fixing from per se consideration.

A decision to overrule *Albrecht* will not alter existing franchise relationships, because it will not amend the existing contracts upon which those relationships are based.

The decision in *Albrecht* and the rational for that decision have been undercut by subsequent decisions concerning territorial restraints and antitrust injury.

Respondent's contentions that he suffered antitrust injury are based on a factual conclusion which is not supported by the record.

ARGUMENT

INTRODUCTION

Contrary to Respondent's contentions, Petitioner's argument is limited to vertical maximum price restraints. Petitioner is not suggesting that competitors should be permitted to agree on prices, even maximum prices. Horizontal agreements are *per se* illegal because they restrict competition by some means. But, the purpose and effect of vertical agreements is different. The actions of any one party in a vertical chain directly affect the well being of every other party in that chain. Khan's sales were also State Oil's sales, and directly affected State Oil's profitability. This Court recognized in *Continental T.V. Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), that certain vertical restraints are not anti-competitive. That ruling has not opened the floodgates for dramatic changes in rules concerning *per se* liability in other areas.

Petitioner is not suggesting, even in a strictly vertical situation, that the per se rule should be abandoned for agreements limiting minimum prices. As this Court recognized in *Albrecht v. Herald Co.*, 390 U.S. 145, 152 (1968), maximum prices and minimum prices have different consequences. Petitioner's argument is limited to the specific ruling in *Albrecht*, making vertical maximum price fixing per se illegal.

Wholesalers and manufacturers, given the opportunity to limit dealer pricing, may make some poor decisions. However, dealers may also make poor decisions. No matter which party makes the decisions, a poor decision will affect, not only the party making the decision, but every other party in the supply chain. The right to make decisions is the essence of the competitive process, and it

should not be limited to only one level of the chain. Petitioner should not be denied, as a matter of law, the right to enter into an agreement authorizing it to participate in decisions concerning maximum pricing. Any potential for abuse which would exist can be controlled by the rule of reason.

Nor is Petitioner asking for a right to control retailers. The relationship between a wholesaler and a retailer is a matter of contract. The wholesaler has an item which it wishes to sell. To insure maximum sales, the wholesaler may wish to impose a condition that the buyer not offer the item to the public for more than a particular amount. The question then becomes whether the buyer is interested on those terms. The resulting agreement will depend on a number of factors, including how badly the buyer wants that item to sell, and how much he thinks the price limitation will affect his profit.

Respondent makes a number of factual assertions which are either unsupported by or contrary to the record. He claims in a number of places that the price which he paid for regular gasoline was above prevailing market (see, e.g., statement on page 19). This statement ignores the specific finding of the lower court,[1] contains

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[1] The lower court stated (Pet. App. 14a) "But State Oil concedes that its contract implicitly obligated it to suggest retail prices (and adjust its wholesale prices accordingly, to maintain the 3.25 cents margin between wholesale and suggested retail price that the contract guarantees) that were realistic in light of competitive conditions facing Khan. The only evidence Khan presented concerning those competitive conditions was evidence that on sixteen occasions during his operation of the station he had called other dealers and been told that their retail prices were lower than the suggested retail prices fixed

(continued...)

no reference to the record, and is unsupported by the record. Demand curves slope downward and thus a reduction in price typically results in increased sales, no matter what the original price level. The Receiver's increased sales mean nothing.

Khan's statements that his margin was too low are not, and could not be, supported by any reference to the record. No evidence was ever offered concerning the relative level of Khan's margin compared to that of competing stations. His statement that his inability to raise his prices was the reason his business failed is another statement which is not, and could not be, supported by a reference to the record.

Aside from the 16 calls made by Khan to other dealers (over the span of a year) to which the lower court made reference,[2] and found wanting, Khan's entire evidence concerning operation of the station is contained in the report of an expert he retained. (JA 33-42) The report contains no findings or assertion that regular gasoline was over priced, that Khan's margin was low, or that Khan went out of business because he could not raise his prices. Apparently, that expert was either unwilling or unable to state that Khan would have been able to stay

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[1] (...continued)
by State Oil. This evidence falls far short of establishing a genuine issue of material fact concerning a breach of contract. There is no evidence that the dealers were actual competitors of Khan or that the prices charged by those dealers were prices for the same grades of gasoline sold by Khan, which, remember, sold a gasoline that has a well-recognized brand name. The evidence is perfectly consistent with an assumption that State Oil's suggested retail prices were competitively realistic."

[2] See note 1, supra.

in business if he had been permitted to price in the same manner as the Receiver. Thus, Khan's contrary claims are mere speculation.

Nor was any evidence presented to support Khan's statement (page 14) that Khan sought to maximize his volume by lowering the price of regular. At no point did Khan ever state that he had requested or recommended a lower price for regular gasoline.[3]

Nor did the expert claim that the actions of the Receiver increased sales by 20%. He reported a claimed increase of approximately 9% (JA 38-39). In addition, the Receiver did not operate the station at a profit. As State Oil pointed out in its statement of material facts filed with its motion for summary judgment (R43, Statements 14 through 18), the Receiver operated the station for nine months. During that time he showed a loss of $71,000.00. In addition, he depleted $44,000.00 worth of opening inventory, for a total loss of $115,000.00 in nine months. In Khan's response (R49, answers 14 through 18), he denies the figures only to the extent that some of the expenses should not be included because the accounting was on a cash basis and State Oil had included accrued payables. Khan's income tax return is attached to the expert"s report (R65, supporting document 11). Khan also lost money, but his loss was $57,000.00 in a year, less $33,000.00 which were start up costs not incurred by the Receiver, for a total loss of only $24,000.00. Thus, it

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[3] State Oil did attempt to assist Khan. Khan attached to his Memorandum in Opposition to Defendant's Motion for Summary Judgment (R48, ex. "B", "C" and "D") three letters from State Oil reducing his rent. Had Khan so requested, State Oil might have been willing to reduce the suggested price, and thus the wholesale price of regular gasoline.

is clear that the Receiver's experience does not validate Khan's claim that the margin limitations imposed by State Oil accounted for Khan's business failure.

I.

VERTICAL MAXIMUM PRICE RESTRAINTS SHOULD BE JUDGED BY THE RULE OF REASON

In discussing the imposition of per se liability in *Continental T.V. Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49, this Court stated that per se rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive, and to agreements or practices which have a pernicious effect on competition and lack any redeeming virtue. This Court has also stated that the scope of the per se rule should be narrow where vertical restraints are involved. *Business Electronics v. Sharp Electronics*, 485 U.S. 717, at 724 (1988). The first consideration, in assessing the appropriateness of per se liability, therefore, is whether the agreement or practice is manifestly anticompetitive or will have a pernicious effect on competition. The second consideration is whether the agreement or practice has any redeeming virtue.

A. Vertical Maximum Price Limitations cannot be used to Reduce Competition: The brief filed by Respondent, along with those briefs filed in support of Respondent, clearly identify a specific concern. The argument in those briefs is that the manufacturer or wholesaler will use maximum price limitations to squeeze the dealer's profit. This concern runs from mere reallocation of gross profit for the benefit of the wholesaler, through the gamut to the wholesaler imposing a profit squeeze to put dealers out of business in order either to appropriate

a franchise fee or to take over the good will which has been built up by the retailer.

These briefs make reference only to the franchise-type relationship, and their argument would apply only in that situation.[4] Unless their contracts are exclusive, dealers are entitled to switch brands at any time and could not be squeezed by a wholesaler. The dealer could then make a business decision whether it was worth his while to merely switch brands. General rules of antitrust law are not appropriate for control of franchise relationships.

Of course, in some situations, franchisors could use maximum price limitations to alter the allocation of profit between franchisors and franchisees. But, the relative profitability of franchisors and franchisees is not an issue in antitrust law. Further, a franchisor which engaged in activities that injured its own franchisees, or reduced their ability to compete, would soon put itself out of business, because it would run out of prospective franchisees. A wholesaler or manufacturer has a strong interest in the health of its retail outlets, including the ability of those outlets to compete and to earn an adequate profit. Those retail outlets are its means of reaching consumers. An otherwise legitimate means of competition should not be automatically forbidden by antitrust law simply because it might reallocate profits in certain limited circumstances.

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[4] The Service Station Dealers of America point out in a footnote at page 9 of their Brief Supporting Affirmance, that according to one source more than one-third of the dollars spent on retail transactions flow through franchised outlets. If that is correct, then two-thirds of the dollars are spent in transactions which do not flow through franchised outlets.

If a wholesaler or manufacturer were so irrational that it sought to drive its own dealers out of business, it need not resort to confiscatory maximum price restrictions. A raise in the wholesale price will accomplish the same purpose. Dealers can be given territories which are too small, they can be given sales quotas which they cannot meet, they can be obligated to provide services which the market will not support. In fact, confiscatory price restrictions would be a poor method of achieving that result.[5]

Respondent makes a claim that the maximum will also become a minimum. But, legitimate concern would exist only if the maximum could somehow be used to force dealers to charge a higher minimum than they would otherwise charge. No one has ever suggested a situation under which this phenomenon could occur. It is not the maximum limit which establishes the minimum price. The minimum price is produced primarily by the cost of the product.[6] This is relatively simple to illustrate by asking what happens if the ceiling is removed. Removal of the ceiling will not, of itself, cause the price to go down, although it may permit the price to go up.

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[5] The claimed squeeze is possible only where either the wholesale price or the maximum price is fixed by the contract, and the franchisor has discretion to change the other. If the dealer's margin is negotiated in advance, as in the situation before the Court, and that margin is too low, the parties merely started into business by making a bad bargain. Protecting merchants from bad bargains is not a function of the antitrust laws. In those situations where the franchisor does have discretionary power under the contract, it is obligated to use that power in good faith UCC §1-203; Restatement, Second, Contracts §205.

[6] See 8 Phillip E. Areeda, *Antitrust Law: An Analysis of Antitrust Principles and Their Application* ¶1637c (1989).

Khan claims, however, that his experience demonstrates that a maximum price ceiling sets a minimum. His argument is based on the fact that he purchased two different grades of gasoline from Petitioner.[7] These are two separate products, purchased by different customers. He claims that he could have used the increased profit from the one product to finance a reduction in price of the other product. A maximum price limitation will prevent a dealer from using one product to offset a price reduction for another product. Khan happened to be purchasing both products from State Oil. However, he was also operating a convenience store and was purchasing items, such as milk, beer or cigarettes from others.[8] If Khan had wished to use one of these items to bring people into the station, and wished to increase the price of gasoline in order to offset his loss, State Oil would simply lose volume and income, and, absent a maximum price limitation, would have no effective response. Khan has not demonstrated that his maximum price for any product had become his minimum price for that product.

Khan also contends that if his price had not been limited, he could have reduced the price temporarily and then recouped at some later time. However, he also

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[7] Khan actually purchased three grades, but Khan's argument here rests on the expert's report, which lumped the two higher grades to produce the figures which he used.

[8] According to the figures produced (JA 39-40), Khan's gross margin on sales for items other than gasoline, referred to as ancillary sales, actually amounted to more than 60% of his total gross margin. The same is true for the Receiver's sales and margin assumptions without the maximum price limitations. Those ancillary sales produced a much higher profit margin and may have been of far more significance than gasoline sales.

makes the point that he has no market power. Without market power, it would have been impossible for him to recoup at some later date. When he raised his price to recoup, his customers would immediately shift to other stations.

The lower court found that the agreement between State Oil and Khan would not be illegal if examined under the rule of reason (Pet. App. 6a), and there seems to be tacit agreement with that conclusion. There is no claim of any effect on anyone other than Respondent. The claim is that franchisors will force their franchisees out of business, thereby reducing competition. However, the mere fact that an activity may cause a business failure does not necessarily mean that the activity will reduce competition or is anticompetitive. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.* 429 U.S. 477 (1977); *Atlantic Richfield Co. v. USA Petroleum Co.* 495 U.S. 328 (1990). The antitrust laws were enacted for the protection of competition, not competitors. *Brunswick Corp. v. Pueblo Bowl-O-Matic, Inc.*, 429 U.S. 477, 488. Respondents make no claim of an injury to competition, only to competitors, which in this case is the dealer himself.

B. Vertical Maximum Price Restraints Can be Used to Promote Competition: The primary concern of the antitrust laws is interbrand competition. *Business Electronics v. Sharp Electronics*, 485 U.S. 717, 726 (1988). One of the most effective means of competition is a price reduction. If maximum price restrictions lower prices, they ordinarily enhance competition. To the degree that *Albrecht* reduces the incentive or ability of manufacturers and wholesalers to use price reductions as a means of competition, it restrains competition.

The situation presented when a dealer has acquired local market power is one of the primary concerns presented in many of the commentaries concerning the effect of *Albrecht*. Despite the statements to the contrary in the briefs filed on behalf of Respondent, dealer market power does exist. Dealer market power exists because of territorial restrictions, the existence of highly favored marketing locations which may be created in part by local zoning,[9] or even markets which are not large enough to support more than one retail outlet. This type of market power, however, was not the power on which Petitioner concentrated.

The power on which Petitioner concentrated was the power which was actually created by *Albrecht*. Normally, there are three parties concerned in the distribution process, the manufacturer, the wholesaler and the dealer. Each of these parties is concerned with sales, and each has a real concern with the price at which the product sells. In fact, the margin added on by the wholesaler and the dealer could be considered as part of the cost incurred by the manufacturer in getting its product to market. The same is true for the wholesaler in connection with the dealer's mark up. Yet, the manufacturer and the wholesaler are forbidden to participate realistically in setting this cost. This is the power which is given solely to the dealer by *Albrecht*.

On page 16 of his brief, Respondent makes the statement:

> "State Oil's profitability depends on its ability and willingness to set a wholesale price which is in sync

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[9] Such as the only gasoline station or fast food outlet at a highway interchange.

> with the retail market price—i.e., a price which permits Khan to maximize volume while earning a sufficient profit to remain in business. That is a risk inherent in selling through dealers. If State Oil does not wish to run that risk, it should operate its gasoline stations directly."

The risk to which Khan is referring, is the risk that the dealer will inappropriately price the product, so as to reduce sales. He argues that a manufacturer or wholesaler who does not wish to run the risk should be required to integrate vertically. But, the antitrust laws were not designed to favor vertical integration. They favor competition, not any particular firm structure.

To speak of "market price" of a particular product as though it were an exact thing is to ignore reality. There is a range of market prices for any product, and sales will depend to some degree on the level within that range at which the particular retailer prices the product. The manufacturer or wholesaler who wishes the product priced at the lower end of that range is not attempting to induce an "artificial" price, he is merely attempting to increase sales.

There is a strong incentive to a wholesaler, such as State Oil, to use a price reduction to enhance sales.[10] However, this incentive is reduced when the wholesaler cannot be assured that a price reduction will not simply be pocketed by the dealer. Petitioner is not intending to imply that dealers are any more acquisitive than persons at any other level of the supply chain. However, each merchant does have an inducement to interpret the situation in the manner which will provide him with the largest profit.

[10] This is particularly true in a situation such as this, where the wholesaler also owns the location from which sales are conducted.

There is a feature to Khan's example, which he has ignored. As set forth above, if the dealer was free to use premium gasoline to subsidize regular gasoline, then he was also free to use gasoline generally to subsidize a price reduction in some other product. State Oil would then be subsidizing the product of some other wholesaler. If denied the right to enter into an agreement establishing maximum prices, it could protect itself only by increasing the price to the dealer in order to make this device uneconomical. This is a poor form of protection.

Albrecht denies to the wholesaler and manufacturer the right to enter into an agreement under which the maximum price charged for its products can be limited.[11] This denial affects the economic position of wholesalers and manufacturers, discourages reliance on nonprice restraints, and adversely affects competition and the economy.

Petitioner's primary contention was twofold; first, that there is no basis for a supposition that dealers have more ability to set competitive prices, and second, that manufacturers and wholesalers are affected equally and directly by the retail price. It is in the best interest of manufacturers and wholesalers, as well as in the interest

[11] For example, because the volume of sales at this location was so important to State Oil, it would have an incentive to price Khan below normal pricing to a dealer. Because gasoline prices fluctuate constantly, a set maximum price is impossible. However, it is possible, by means of a margin limitation, to guarantee Khan a margin which he believes is adequate, while at the same time assuring that he will not pocket the price reduction.

of consumers, that the price charged maximize volume in the environment of interbrand competition. Wholesalers and manufacturers should not be denied the right to enter into contracts which enhance the potential for effective sale of their products. Respondent has not responded to this argument.

C. Concern for Prior Decisions Should Not Mandate *Per Se* Treatment in This Case: In the brief filed by Respondent (note 4, page 15), and in other briefs filed in support of Respondent's position, there are references to statements made in support of legislation considered by Congress in 1991, relating to price fixing. Those statements might provide Respondent's position with some support except for two facts. The first fact is that the proposed amendment to the antitrust laws did not pass. Second, and of even greater significance, is that the proposed amendments (H.R. 1470, Congressional Record - House, October 10, 1991, H 7757, and S.429, Congressional Record - Senate, May 9, 1991, S 5605) excluded maximum price. S. 429 specifically provided that vertical maximum resale price agreements are to be considered under the rule-of-reason.

Respondent also contends that franchise investments have been based on the existing interpretation of the antitrust laws. This assertion of a reliance interest is not correct. Franchises are based on contracts. A decision overruling *Albrecht* will not amend those contracts and give franchisors additional rights over existing franchises. Petitioner is merely asking for removal of the *Albrecht* restriction on its right to enter into a contract containing limitations on maximum price levels.

The parties appear to agree that existing authority should be overruled when the development of the law has undercut the conceptual underpinning of a prior decision or where developments have rendered the decision irreconcilable with other legal doctrines. The difference of opinion lies in how that standard applies to this case.

Petitioner had argued that when *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) was overruled by *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), the rationale upon which *Albrecht* was based was severely undercut. Respondent disputes that position, arguing that "*Albrecht* is more properly characterized as grounded upon the ban on price fixing than upon the *per se* ban on non-price vertical restraints."

Respondent's argument is mistaken. The decision in *Albrecht* was not based on any analysis of an effect on competitive pricing. It was based on the effect which price limitations might have upon the dealer whose prices were being restricted, and as Respondent suggests, upon a reaction to the concept of price fixing, *per se*. But, in *GTE Sylvania*, (433 U.S. at 57), this Court reverted to the standard articulated in *Northern Pac. R. Co. v. United States*, 356 U.S. 1, 5, (1958) and reiterated in *White Motor Co. v. United States*, 372 U.S. 253 (1963), that vertical restrictions are conclusively presumed to be unreasonable, only when those restrictions have or are likely to have a pernicious effect on competition or lack any redeeming virtue. That is, departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic labeling (433 U.S. at 58-59). Each of these statements could be applied as effectively to *Albrecht* as they were to *Schwinn*.

Respondent argues that *Albrecht* is based on an objection to price fixing. This is quite possibly correct, but is formalistic labeling rather than realistic appraisal. Per se liability in *Albrecht*, as in *Schwinn*, was based on a standard which has been rejected by this Court, and is no longer applicable.

II.

RESPONDENT DID NOT SUFFER AN ANTITRUST INJURY

Khan's claim that he suffered antitrust injuries is based on his statement (page 19) that the suggested pump price of regular gasoline was higher than the prevailing market and that he could not profitably compete on regular gasoline. As stated above, there is no support in the record for these statements.

Khan then goes on to state that he lost money because he could not increase his prices o. premium gasoline to offset losses on regular gasoline. He implies in the way he makes this statement that he was losing money on regular gasoline. More precisely, the claim is that he would lose margin per gallon by reducing the price of regular gasoline.[12] Whether he would actually lose money by doing so would depend on whether increased sales (both of gasoline and in the convenience store) were

[12] The receiver earned an average margin of $0.0382 per gallon (JA 39) during the time selected for the study, contrasted with the $0.0325 permitted Khan. Therefore, although some customers paid more and some paid less, on average a customer who purchased gasoline at this station paid more for his gasoline than he would have paid under the restrictions imposed on Khan.

adequate to make up for the lost margin. Khan's claim is that this is the reason he lost his business, a claim which has no support in the record. Khan attempts to make claims of antitrust injury, based on statements contained in *Albrecht* and *Atlantic Richfield* about the nature of possible problems created by maximum vertical price restraints. There is, however, no claim that customers were deprived of any services which would have enhanced the value of the products he was selling, or that the agreement in any way advanced the position of other gasoline dealers. The only claim which has any support in the record is his claim that he could have earned more money by increasing the price of premium gasoline. Every other statement is pure speculation.

Khan was contesting a motion for summary judgment, and was obligated to present sufficient evidence to show the existence of any injury which he claimed. *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed. 2d 265 (1986). If he wished to advance these contentions to provide antitrust injury, he should have done so.

Antitrust injury does not arise for purposes of §4 of the Clayton Act until a private party is adversely affected by the aspect of the defendant's conduct which makes it anticompetitive. *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990). Even assuming *arguendo* that the margin limitation agreed upon between State Oil and Khan drove Khan out of business, Khan has demonstrated antitrust injury only if it is an anticompetitive act to drive your own dealers out of business. Certainly competing stations did not suffer. Except in the short term, they did not gain either. The station was still there. If it was a viable location, it would be operated by someone else, possibly by someone who would operate it more efficient-

ly than Khan. If it was not a viable location, then it was doomed from the start.

The argument which Khan is making suggests that although no antitrust injury arises from driving your competitors out of business, it does arise from driving out your own dealers. That is, there is an antitrust injury if you drive out your own dealers by means of pricing limitations, but none if you drive them out by merely terminating them, or creating unfortunate territorial restrictions.

There is only one possible basis for an argument that a result produced by pricing restraint would produce antitrust injury, whereas that same result produced by some other provision such as territorial restraints would not; that pricing restraints trigger *per se* liability, whereas other vertical restraints do not. The argument that actions which are per se violations automatically generate antitrust injury was negated by this Court in both *Brunswick* and *Atlantic Richfield*.

What this argument demonstrates is that the development of the law, not only concerning other types of vertical restraints, but also antitrust injury, has undercut the conceptual underpinning of *Albrecht*, and that subsequent developments have rendered *Albrecht* irreconcilable with other, more current, legal doctrines.

CONCLUSION

The conceptual underpinning of *Albrecht* has been so seriously undercut by subsequent decisions concerning both territorial restraints and antitrust injury, that the decision is no longer supportable. There is no reason, based on competitive factors, to deny manufacturers and wholesalers the right to enter into contracts which limit the maximum price which can be charged for the products which they are selling. They are as influenced by the market, and as eager to respond to that market as are retailers. Petitioner respectfully prays that this Court reverse the decision of the Court of Appeals and reinstate the decision of the district court in this cause.

Respectfully submitted,

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No. 96-871

In the Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY, PETITIONER

v.

BARKAT U. KHAN AND KHAN & ASSOCIATES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL TRADE COMMISSION AS AMICI CURIAE SUPPORTING REVERSAL

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34 pp

QUESTION PRESENTED

The United States and the Federal Trade Commission will address the following question:

Whether petitioner's contractual imposition of maximum resale prices for the gasoline it sold to respondents, who operated a retail gasoline dealership, was a per se violation of Section 1 of the Sherman Act.

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INTEREST OF THE UNITED STATES AND THE FEDERAL TRADE COMMISSION

The United States and the Federal Trade Commission have primary responsibility for enforcing the federal antitrust laws. This case presents the question whether an agreement between a supplier and its dealer that effectively sets the dealer's maximum resale price constitutes a per se violation of Section 1 of the Sherman Act, 15 U.S.C. 1, or is instead properly analyzed under the rule of reason. The Court's resolution of that question may affect both federal antitrust enforcement and the extent to which private

enforcement of the antitrust laws achieves its intended purpose.

STATEMENT

1. Respondent Khan entered into a lease and supply agreement (the Agreement) to operate a gas station and convenience store owned by petitioner State Oil Company. Pet. App. 1a. The Agreement provided that respondent would ordinarily obtain his entire supply of gasoline from petitioner, at a price equal to a "suggested" retail price set by petitioner, less retail sales tax and a margin of 3.25 cents per gallon. Pet. App. 2a-3a, 25a.

The Agreement did not specify the price respondent could charge for gasoline. If, however, he charged more than petitioner's "suggested" retail price, the Agreement required that he rebate to petitioner the entire amount by which his price exceeded the suggested price, multiplied by the total number of gallons sold. Pet. App. 2a, 25a. Consequently, increasing the retail price of gasoline would not increase respondent's margin at all, and would increase his net revenue only in the unlikely event that it increased the amount of gasoline he sold. The Agreement did not specify any consequences if respondent were to sell below the suggested retail price, but provided that petitioner would not lower its price to preserve respondent's per-gallon margin. *Ibid.* Thus, reducing retail prices would decrease respondent's revenue per gallon, but would increase his total revenue if it led to a sufficient increase in sales.

About a year after respondent began operating the station, petitioner notified him that it intended to terminate the Agreement on the ground that he had

not paid the agreed rent. Pet. App. 2a, 26a. An Illinois court later appointed a receiver, who operated the station for nine months. *Id.* at 26a-27a.

2. Respondent sued petitioner, alleging, among other things, resale price fixing in violation of Section 1 of the Sherman Act, 15 U.S.C. 1. Respondent contended that the Agreement fixed prices by preventing him from raising or lowering his retail prices and that, but for the Agreement's pricing provisions, he would have charged different prices and increased his income. Pet. App. 34a. Petitioner argued that the Agreement left Khan free to charge whatever price he wished. *Ibid.*

The district court first ruled that respondent's price fixing claim did not allege a per se violation of Section 1, but should instead be analyzed under the "rule of reason." Pet. App. 35a. In the court's view, the alleged facts did not establish the sort of "manifestly anticompetitive implications" or "pernicious effect on competition" that would justify application of the per se rule. J.A. 43 (Order of Sept. 12, 1995). Later, evaluating respondent's claim on petitioner's motion for summary judgment, the court concluded that he had "failed to demonstrate antitrust injury, harm to competition, a relevant market for analysis and market power." Pet. App. 37a. Indeed, in the court's view, respondent had "not even attempted to demonstrate * * * the effect of the pricing provisions on competition in a relevant market." *Id.* at 40a. The court held that an expert's report offered by respondent to show that, but for the pricing provisions of the Agreement, he would have made more money would not be admissible at trial, and in any event was insufficient to establish the intended proposition. *Id.* at 39a.

3. The court of appeals reversed. In an opinion by Chief Judge Posner, the court first noted that the Agreement did not fix minimum prices, because it merely stated petitioner's intention not to lower its wholesale price in the event that respondent wished to charge a lower retail price—something that petitioner had, in any event, no obligation to do. Pet. App. 2a-3a. The court held that the Agreement did fix *maximum* prices, however, because the pricing terms made it "worthless" for respondent to exceed the price set by petitioner and amounted to "an alternative sanction to termination, and probably an equally effective one." *Id.* at 3a-4a.

After reviewing briefly the legal and economic aspects of various sorts of price fixing (Pet. App. 4a-6a), the court concluded that maximum price fixing of the sort involved in this case remains per se illegal under this Court's decision in *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968). The court expressed "considerable sympathy" with petitioner's argument that *Albrecht* had been superseded by later cases establishing that a private party does not have standing to maintain an antitrust action unless it can show "antitrust injury," which would not normally be possible in a maximum price fixing case "[i]f typically and here a resale price ceiling imposed by a seller merely prevents his dealers from reaping monopoly profits." Pet. App. 8a. The court also noted (*ibid.*) that this Court's decision in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977), had changed the law on vertical non-price restraints (such as exclusive dealer territories) in a way that might affect the reasoning of *Albrecht*. Despite, however, its view that "*Albrecht* was unsound when decided, * * * is inconsistent with later decisions by the

Supreme Court[,] * * * [and] should be overruled," the court concluded that the *Albrecht* rule remained controlling. Pet. App. 9a.

In light of *Albrecht* and of *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 495 U.S. 328, 336-337 (1990), the court rejected petitioner's argument that respondent had alleged no cognizable antitrust injury: "The implication [of those cases] is that the injury to a dealer like Khan from not being able to raise his price because of a restriction imposed by his supplier is antitrust injury." Pet. App. 11a. Finally, although it noted that respondent was nonetheless required to demonstrate "injury in fact" (*ibid.*), the court held that the expert report submitted by respondent was admissible and "sufficiently plausible to defeat summary judgment on the question of injury" (*id.* at 13a). The court therefore remanded the case for further proceedings.[1]

SUMMARY OF ARGUMENT

Although the Sherman Act by its terms prohibits every agreement "in restraint of trade," this Court has long recognized that Congress intended to outlaw only "unreasonable" restraints. While most antitrust claims are therefore analyzed under a "rule of reason," analysis and experience indicate that some

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[1] Judge Ripple concurred, writing separately "to note that I share my colleagues' substantive criticism of the per se rule as it has been applied to vertical maximum price-fixing" and to suggest that this case could be distinguished from *Albrecht* on the ground that it "involves a single contract between a single wholesaler and a single retailer" which does not "implicate any other entities," so that "the threat of horizontal cartelization is absent or, at the very least, greatly diminished." Pet. App. 16a-17a.

types of restraint have such pernicious anti-competitive effects, and so little potential for pro-competitive benefits, that they are condemned as unlawful "per se." The paradigmatic example is "horizontal" price fixing among competitors, and per se condemnation was early applied as well to "vertical" agreements through which suppliers set the minimum resale prices to be charged by their distributors. In its 1967 decision in *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, the Court initially extended the same sort of per se prohibition to vertical non-price restraints, including the enforcement of exclusive distribution territories.

It was in this context that the Court undertook its only previous plenary consideration of the issue of vertical *maximum* price fixing. In *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968), the Court invoked the per se rule that is applied against horizontal price fixing. It was argued in that case that vertical maximum price restraints could have important pro-competitive effects when used to counteract the intrabrand monopoly conferred by exclusive distribution territories. The Court rejected that argument, however, in large part because the decision in *Schwinn* had recently held that in most cases the establishment of such territories was also per se illegal.

Although it is possible to interpret *Albrecht* narrowly, we agree with the court of appeals that, fairly read, the Court's opinion announced a per se rule against vertical maximum price fixing, and that that rule would normally cover this case. Since *Albrecht*, however, the Court has overruled the decision in *Schwinn*, which provided the primary basis for *Albrecht*'s rejection of the pro-competitive justification offered for the use of maximum retail price

agreements. In light of the subsequent rejection of the *Schwinn* rule, this Court itself has recognized that the pro-competitive potential of such agreements is "more evident now than it was when *Albrecht* was decided." *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 495 U.S. 328, 343 n.13 (1990). It is therefore appropriate for the Court to reconsider *Albrecht*'s approach to this type of restraint.

Per se illegality is appropriate only for practices that "always or almost always tend to restrict competition and decrease output." *Broadcast Music, Inc.* v. *CBS*, 441 U.S. 1, 19-20 (1979). Maximum vertical price fixing, however, may serve the important and pro-competitive purpose of limiting a dealer's ability to exploit market power. On the other hand, the possible anti-competitive effects of such arrangements articulated in *Albrecht* do not appear to be so frequent, so serious, or so unlikely to escape detection and remedy as to justify a per se rule, which may itself create perverse incentives leading to inefficiency, higher consumer prices, and the elimination of small business opportunities.

In the 30 years since *Albrecht* was decided, it has generated extensive legal and economic discussion. The consensus of commentators is that *Albrecht*'s per se rule should be replaced. The *Albrecht* rule has played little or no role in government enforcement efforts, and we are confident that anti-competitive uses of such restrictions may be adequately policed under the rule of reason. While the importance of *stare decisis* is unquestioned, in this case the development of antitrust law, and in particular the overruling of *Schwinn*, have significantly changed the legal landscape in which *Albrecht* was decided. Tak-

ing account of all these factors, we believe that *Albrecht*'s per se prohibition should be overruled.

ARGUMENT

PURELY VERTICAL AGREEMENTS FIXING MAXIMUM RESALE PRICES SHOULD BE EVALUATED UNDER THE RULE OF REASON

A. The Origins Of *Albrecht*

Section 1 of the Sherman Act prohibits "[e]very contract, combination * * *, or conspiracy, in restraint of trade or commerce among the several States." 15 U.S.C. 1. This Court long ago recognized, however, that "Congress could not have intended a literal interpretation of the word 'every,'" and most arrangements challenged as restraints of trade are therefore analyzed to determine "whether under all the circumstances of the case the restrictive practice imposes an *unreasonable* restraint on competition." *Arizona* v. *Maricopa County Med. Soc'y*, 457 U.S. 332, 343 (1982) (emphasis added); see also *Standard Oil Co.* v. *United States*, 221 U.S. 1, 62 (1911).

In some cases, however, the Court has determined that "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Maricopa*, 457 U.S. at 344. When the Court has been satisfied that restraints of a certain type will, in the great majority of cases, have a "pernicious effect on competition" unjustified by "any redeeming virtue," it has condemned them categorically. *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958); see also, *e.g.*, *Business Elec. Corp.* v. *Sharp Elec. Corp.*, 485 U.S. 717, 723-724 (1988). Appropriate "per se" rules of this

type "tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system of the more complex rule-of-reason trials." *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 50 n.16 (1977). See also, *e.g.*, *Atlantic Richfield Co.* v. *USA Petroleum Co.* (*ARCO*), 495 U.S. 328, 342 (1990); Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1489 (1983).

The paradigmatic per se antitrust violation has always been "horizontal" price fixing—the coordinated setting of prices by or among competitors. See, *e.g.*, *Maricopa*, 457 U.S. at 344-346; *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 218 (1940); *United States* v. *Trenton Potteries Co.*, 273 U.S. 392, 398 (1927). Early in this century, the Court applied the same per se treatment to "vertical" agreements between a supplier and a distributor that set minimum resale prices the distributor may charge its customers for the supplier's products. *Dr. Miles Med. Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911); see also, *e.g.*, *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984). In 1951, the Court made clear that the per se rule applies to any price agreement among competitors, whether the agreement fixes minimum or maximum prices. *Kiefer-Stewart Co.* v. *Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 213.[2]

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[2] *Kiefer-Stewart* involved an agreement among suppliers to fix the maximum resale prices charged by the wholesalers next in the distribution chain, and therefore had overtones of vertical price fixing. It seems clear from the Court's opinion, however, that the decision was based principally on the horizontal agreement between competing suppliers. 340 U.S.

The 1960's brought important developments in the Court's analysis of vertical arrangements, related to but distinct from those at issue here, through which suppliers may seek to impose restrictions on their dealers with respect to matters *other* than resale prices. In *White Motor Co.* v. *United States*, 372 U.S. 253 (1963), the Court for the first time considered the validity of vertical restrictions conferring exclusive dealer territories. See *id.* at 261. The Court reversed a summary judgment in favor of the government, holding that too little was known about "the economic and business stuff out of which these arrangements emerge" and their "actual impact * * * on competition" to justify per se condemnation. *Id.* at 263. Four years later, however, in *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), the Court held that, once title to goods had been transferred to a distributor, territorial or customer restrictions imposed by a supplier on their resale were "so obviously destructive of competition" as to be illegal per se. *Id.* at 379, 382.

It was in this context that the Court first gave plenary consideration to the issue of vertical maximum price fixing.[3] In *Albrecht* v. *Herald Co.*, 390 U.S. 145

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at 213-214; see also *ARCO*, 495 U.S. at 336 n.6; *Maricopa*, 457 U.S. at 348 & n.18; *Albrecht*, 390 U.S. at 164-165 (Harlan, J., dissenting); *White Motor Co.* v. *United States*, 372 U.S. 253, 260 (1963); but see *Albrecht*, 390 U.S. at 152 & n.8. A different aspect of the decision in *Kiefer-Stewart* was overruled in *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752 (1984).

[3] In *White Motor Co.* v. *United States*, 372 U.S. at 264, the Court arguably "intimate[d]" its approval of a judgment that certain vertical maximum price restrictions were illegal per se. See also *id.* at 257, 260. The opinion in *White Motor*

(1968), the Court considered the legality of actions taken by a newspaper publisher to induce one of its distributors to comply with maximum resale prices set by the publisher. The Court first concluded (*id.* at 149-150) that the publisher's conduct, which involved hiring other parties to sell papers at the desired price to customers on the distributor's assigned route, was not "wholly unilateral," and therefore satisfied the "combination" requirement of the Sherman Act.

The Court went on to reject (390 U.S. at 151-154) the argument (stated *id.* at 149) that there was "no restraint of trade * * * [in] a situation in which a seller establishes maximum prices to be charged by a retailer enjoying an exclusive [resale] territory." Citing cases dealing with horizontal price fixing, the Court reaffirmed *Kiefer-Stewart*'s denunciation of maximum (as well as minimum) price agreements, and applied it to the case of a supplier that imposed maximum prices on its distributor. The Court concluded that "the combination formed by the [publisher] in this case to force [the distributor] to maintain a specified price for the resale of the newspapers which he had purchased from respondent constituted, without more, an illegal restraint of trade under § 1 of the Sherman Act." 390 U.S. at 153.

Finally, the Court rejected the suggestion that the publisher's fixing of maximum prices should be permitted because the publisher granted distributors exclusive routes and then set maximum prices to prevent "price gouging by dealers who had monopoly power in their own territories." 390 U.S. at 153. The Court pointed out that the factual predicates for such

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repeatedly noted, however, that the validity of the price-fixing provisions was not before the Court. *Id.* at 256-257 nn.2-3, 260.

a justification had not been established below: "[N]either the existence of exclusive territories nor the economic power they might place in the hands of the dealers was at issue before the jury." *Ibid.* Similarly, no evidence had been presented below about the nature of the exclusive territories, and the Court expressed skepticism that any price restraint could be justified on the ground that it was part of a larger scheme involving exclusive dealer territories, which the Court had so recently held were themselves per se illegal under normal circumstances. *Id.* at 153-154, citing *United States* v. *Arnold, Schwinn & Co.*, *supra*.

B. Interpretation Of *Albrecht*

It is possible to articulate a very narrow interpretation of *Albrecht*. The Court rejected a proffered economic justification for setting maximum prices—the existence of exclusive dealer territories—on the grounds that it had not been argued or factually developed in the district court and that it probably would not have been persuasive in any event, given the law at the time concerning vertical non-price restraints. 390 U.S. at 153-154. It is not, therefore, clear that the Court intended its holding with respect to the case as it was tried to establish a true per se rule, under which any justification, no matter how well developed, would have been simply irrelevant. See also *id.* at 154-156 (Douglas, J., concurring); compare, *e.g.*, *Socony-Vacuum*, 310 U.S. at 221-222. On this view, the Court's comment that the facts presented showed liability "without more," 390 U.S. at 153, means only that vertical maximum price fixing raises sufficient antitrust concerns that a plaintiff who alleges it makes out a prima facie case for

liability, which will be successful if the defendant offers no pro-competitive justification for its actions—not that such a plaintiff is automatically entitled to prevail, without regard to any justification that may be offered.

Although in some ways appealing, this and other possible narrow interpretations of *Albrecht* are ultimately unsatisfying as fair readings of the Court's opinion. The *Albrecht* Court clearly thought that its decision would apply to a direct agreement between a supplier and one or more dealers (390 U.S. at 150 n.6), and it clearly believed that the case could be resolved, without extended analysis, on the basis of precedent dealing with the per se rule against horizontal price fixing. Both this Court and lower courts have subsequently read the decision as establishing a rule that purely vertical maximum price restraints are illegal per se.[4] *Albrecht* may have been incorrectly decided, or the surrounding legal landscape may, as we argue below, have changed so significantly in later years that the decision should now be reconsidered. Without a fundamental reinterpretation provided by this Court, however, we agree with the court of appeals (Pet. App. 10a) that *Albrecht* established a per se rule,

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[4] See, *e.g.*, *ARCO*, 495 U.S. at 335-336 & nn. 5-6; *Business Elec.*, 485 U.S. at 735; *Acquaire* v. *Canada Dry Bottling Co. of N.Y.*, 24 F.3d 401, 409 (2d Cir. 1994); *Caribe BMW, Inc.* v. *Bayerische Motoren Werke Aktiengesellschaft*, 19 F.3d 745, 752-753 (1st Cir. 1994) (Breyer, C.J.); *Fineman* v. *Armstrong World Indus., Inc.*, 980 F.2d 171, 213 (3d Cir. 1992), cert. denied, 507 U.S. 921 (1993); *Blanton* v. *Mobil Oil Corp.*, 721 F.2d 1207, 1211 (9th Cir. 1983), cert. denied, 471 U.S. 1007 (1985); *Carlson Mach. Tools, Inc.* v. *American Tool, Inc.*, 678 F.2d 1253, 1261 (5th Cir. 1982).

and that the decision "cannot fairly be distinguished from this case."[5]

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[5] The petition for certiorari in the present case states separately the question whether the damages claimed by respondents constitute "antitrust injury." Pet. i (Question 1), 4-7; see, *e.g.*, *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977). In our view, the proper resolution of that question is intertwined with the question whether purely vertical maximum resale price maintenance is still to be considered per se illegal for the reasons articulated in *Albrecht*. The court of appeals did not err in holding (Pet. App. 10a-11a) that respondents alleged the sort of injury recognized by the *Albrecht* Court. See also *Atlantic Richfield Co.* v. *USA Petroleum Co.* (*ARCO*), 495 U.S. 328, 345-346 (1990); *Caribe BMW*, 19 F.3d at 752-754; cf. *Lear, Inc.* v. *Adkins*, 395 U.S. 653, 670-671 (1969) (patent licensees "may often be the only individuals with enough economic incentive" to vindicate the public interest by challenging the validity of a patent).

If, however, the Court in this case abandons or reformulates the rule of *Albrecht*, then what is necessary to show antitrust injury in this context will depend on what legitimate antitrust concerns, if any, remain regarding the agreement at issue. That is a question that, in our view, could appropriately be addressed in the first instance by the court of appeals, if that court determines on remand that it would be appropriate to afford respondent a further opportunity to make his case under the rule of reason. We therefore address ourselves principally to the *Albrecht* question. The Court should, however, make clear that, contrary to the court of appeals' implication (Pet. App. 10a), principles of antitrust injury that affect the ability of private plaintiffs to bring damage actions under Section 4 of the Clayton Act, 15 U.S.C. 15, do not limit the authority of the United States or the Federal Trade Commission to enforce the antitrust laws, including whatever limits they place on vertical maximum price-fixing, in appropriate cases. See Sherman Act § 4, 15 U.S.C. 4; Federal Trade Commission Act § 5, 15 U.S.C. 45.

C. Development Of The Law Since *Albrecht*

As discussed above, *Albrecht* rejected the suggestion that maximum price fixing was justifiable as an adjunct to the granting of exclusive dealer territories in part because the Court had recently held, in *Schwinn*, that the creation of such territories was illegal per se. *Albrecht*, 390 U.S. at 153-154.[6] Nine years later, however, the Court reconsidered *Schwinn* in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977). Reverting to *White Motor*'s more cautious approach of developing experience and understanding "the actual impact of these arrangements on competition" before condemning them per se (*GTE*, 433 U.S. at 50-51, quoting *White Motor*, 372 U.S. at 263), the Court canvassed the "substantial scholarly and judicial authority supporting th[e] economic utility" of vertical non-price restraints. *GTE*, 433 U.S. at 57-58. That authority showed that although such restrictions (and, in particular, territorial restraints) reduced *intra*brand competition, they had significant "redeeming virtues" in promoting *inter*brand competition by allowing a manufacturer to achieve more efficient distribution of its products. *Id.* at 54 (quoting *Northern Pac. Ry.*, 356 U.S. at 5); see also 433 U.S. at 54-57. Faced with "relatively little authority to the contrary" (*id.* at 58), the Court concluded that *Schwinn* should be overruled and that vertical non-price restraints should be judged under the rule of reason.

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[6] *Schwinn* applied a per se rule only to cases in which the supplier sold goods outright to its distributors, as opposed to treating distributors as agents and delivering goods to them only on consignment. *Schwinn*, 388 U.S. at 379-380. The former appeared to be the case in *Albrecht*. 390 U.S. at 147.

As we have noted, the *GTE* Court recognized (433 U.S. at 54) that non-price restraints such as exclusive dealer territories raise legitimate antitrust concerns because they tend to reduce *intra*brand competition. The Court explained, however, that "the ability of retailers to exploit the resulting [exclusive] market may be limited" by other factors, such as the *inter*brand competition that such restrictions could help facilitate. *Ibid.* Yet it was just this sort of moderating effect—"blunt[ing] the pernicious consequences" of exclusive dealership territories—that the *Albrecht* Court had rejected (390 U.S. at 154) as a potential justification for the fixing of maximum resale prices. Although the rationale for that rejection may have had greater force in 1968, when exclusive territories were themselves per se illegal, it was rendered anachronistic by *GTE*'s opening of the validity of such territories to rule-of-reason analysis and adjudication.

GTE distinguished its treatment of non-price vertical restrictions from the continued per se treatment of vertical price restraints. 433 U.S. at 51 n.18. The Court's discussion of the latter makes clear, however, that it was focusing on the fixing of minimum, not maximum, prices.[7] This case involves no minimum

[7] The risks of cartelization and lessened interbrand competition mentioned by the Court in *GTE*, and the sources cited, relate to the fixing of *minimum* prices. Similarly, the congressional approval of per se analysis inferred by the Court (433 U.S. at 51 n.18) from repeal of the federal antitrust exemptions for state "fair trade" laws would not extend to maximum price restraints, because the sort of "fair-trade pricing" (*ibid.*) covered by those laws—and certainly the sort that concerned Congress when, at a time of rapid inflation, it repealed the federal exemptions—typically involved only the setting of

price fixing, see Pet. App. 2a-3a, and its result need

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minimum prices. See generally Miller-Tydings Fair Trade Act, ch. 690, § 1, 50 Stat. 693 (1937) (authorizing States to permit "contracts or agreements prescribing *minimum* prices for * * * resale") (emphasis added); McGuire Act, Pub. L. No. 542, § 1, 66 Stat. 632 (1952) ("minimum or stipulated prices"); H.R. Rep. No. 341, 94th Cong., 1st Sess. (1975) (emphasizing, for example (*id.* at 3), that "From the consumers' point of view, 'fair trade' laws have one effect—higher prices."); S. Rep. No. 466, 94th Cong., 1st Sess. (1975); 121 Cong. Rec. 23,658-23,662 (1975) (House debate); *id.* at 23,660 (statement of Rep. McClory) (contending that "maximum price maintenance" would not be affected by the proposed repeal); 121 Cong. Rec. 38,049-38,051 (1975) (Senate debate); see also, *e.g.*, *Broussard* v. *Socony Mobil Oil Co.*, 350 F.2d 346, 349 n.8 (5th Cir. 1965).

While it was considering repeal of the "fair trade" exemption, the Senate Judiciary Committee held hearings on a proposed provision explicitly permitting newspaper publishers to set maximum resale prices. *Fair Trade Laws: Hearings Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess., Pt. 2 (1975). The amendment "was not brought to a vote because of lack of support for it." S. Rep. No. 466, *supra*, at 3; see also 121 Cong. Rec. 38,051 (1975) (remarks of Sen. Hruska). Failure to enact or vote on a legislative proposal is not, of course, comparable in significance to a congressional enactment, such as the repeal of the "fair trade" exemption. See, *e.g.*, *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 186-187 (1994). And, in any event, the fact that Congress in 1975 had no interest in trading one specific antitrust exemption for another does not suggest that it intended that vertical maximum price setting be per se illegal. As noted above, the entire tenor of the congressional debate reflects hostility to the setting of minimum, not maximum, prices. But see H.R. Rep. No. 341, *supra*, at 2 (citing *Albrecht*); *Bowen* v. *New York News, Inc.*, 522 F.2d 1242, 1249-1250 (2d Cir. 1975) (applying McGuire Act to maximum price maintenance), cert. denied, 425 U.S. 936 (1976).

have no implication for the law in that area. Similarly, this case involves no issue of maximum price fixing among horizontal competitors. Compare, *e.g.*, *Maricopa*, *supra*.

As both the Court and commentators have recognized, the issue of vertical, maximum price restraints is analytically quite distinct from other "price fixing" issues.[8] Indeed, in recent years the Court, without retreating from the per se approach to other agreements involving price, has explicitly recognized that, in the wake of *GTE*, "[t]he *pro*competitive potential of a vertical *maximum* price restraint is more evident now than it was when *Albrecht* was decided." *ARCO*, 495 U.S. at 343 n.13 (emphasis added). From 1968 until the present case, however, *Albrecht* remained "the only case in which the Court

[8] See, *e.g.*, 8 P. Areeda, *Antitrust Law* ¶ 1637b (1989); 3A P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 76063 (1996); Pitofsky, *supra*, 71 Geo. L.J. at 1490 n.17. In particular, any discussion or agreement concerning price *among competitors* has always been viewed as a matter at the very center of antitrust concern. See, *e.g.*, Areeda, *supra*, ¶ 1637c n.11 ("[C]ompetitors have so strong an incentive to escape price competition that it is exceedingly dangerous to allow them to discuss and come to *any* kind of consensus about price."). The prohibition of vertical minimum price maintenance rests in part on concerns about facilitating or concealing exactly such horizontal collusion. See, *e.g.*, *Dr. Miles*, 220 U.S. at 407-408; Pitofsky, *supra*, 71 Geo. L.J. at 1490-1491. Purely vertical, *maximum* price agreements, on the other hand, present little or no similar danger. Moreover, in the case of vertical *minimum* price fixing, suppliers' stated concerns (such as inducing dealers to provide adequate point-of-sale services) could often be addressed directly in a distribution agreement without reference to price (by, for example, requiring the distributor to provide a certain level of facilities or services to its customers).

ha[d] confronted an unadulterated vertical, maximum-price-fixing arrangement." *ARCO*, 495 U.S. at 336 n.6. It is therefore appropriate for the Court in this case to reconsider its approach to this particular category of restraints.

D. Vertical Maximum Price Fixing Should Be Analyzed Under The Rule Of Reason

Since *GTE*, this Court has reaffirmed that it will hesitate to adopt per se rules applicable to "restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious." *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458-459 (1986); see also *National Collegiate Athletic Ass'n* v. *Board of Regents of the Univ. of Okla.*, 468 U.S. 85, 103-104 (1984). Per se condemnation is appropriate only if a particular type of restraint "appears to be one that would always or almost always tend to restrict competition and decrease output." *Broadcast Music, Inc.* v. *CBS*, 441 U.S. 1, 19-20 (1979). Vertical maximum price-fixing agreements do not satisfy that standard.

1. The primary pro-competitive justification adduced in support of maximum vertical price fixing is the one the Court refused to countenance in *Albrecht*, but which it has since elaborated with apparent approval:

> When a manufacturer provides a dealer an exclusive area within which to distribute a product, the manufacturer's decision to fix a maximum resale price may actually protect consumers against exploitation by the dealer acting as a local monopolist. The manufacturer acts not out of altruism, of course, but out of a desire to increase its own sales—whereas the dealer's

> incentive, like that of any monopolist, is to reduce output and increase price.

ARCO, 495 U.S. at 343 n.13. Professor Areeda makes the same point:

> A dealer, although small in absolute terms, may enjoy a considerable degree of monopoly power in its local market. Like any other monopolist, it is likely to restrict output and raise price, to the detriment of both the manufacturer and consumer. The detriment to the consumer is obvious: higher prices. The detriment to the manufacturer is equally clear: fewer sales. The manufacturer thus serves both his own interests and those of consumers by restraining the dealers' exercise of monopoly power and preventing dealers from profiting more than is necessary for effective performance of the distribution function. This protects the public from price gouging.

8 P. Areeda, *Antitrust Law* ¶ 1636a, at 395 (1989); see also, *e.g.*, *Caribe BMW*, 19 F.3d at 753 (maximum resale price agreement can be used to "protect[] consumers from the exercise of a retailer's monopoly power."); *Albrecht*, 390 U.S. at 158-159 (Harlan, J., dissenting).[9] The Herald Company asserted that very purpose for its attempt to impose maximum

[9] For a more formal exposition of the economic principles involved, see, *e.g.* Spengler, *Vertical Integration and Antitrust Policy*, 58 J. Pol. Econ. 347 (1950); Machlup & Taber, *Bilateral Monopoly, Successive Monopoly, and Vertical Integration*, 27 Economica 101 (1960); J. Tirole, *The Theory of Industrial Organization* 173-177 (1988); Blair & Esquibel, *Maximum Resale Price Restraints in Franchising*, 65 Antitrust L.J. 157, 161-167 (1996).

prices on its distributors. See *Albrecht* v. *Herald Co.*, 367 F.2d 517, 519 (8th Cir. 1966) (quoting publisher's letter to Albrecht), rev'd, 390 U.S. 145 (1968).

2. On the other side of the balance, *Albrecht* identified several concerns that might be raised by vertical maximum price fixing. First, the Court pointed out (390 U.S. at 152-153) that "[m]aximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which consumers desire and for which they are willing to pay," thus "severely intrud[ing] upon the ability of [wholesale] buyers to compete and survive in th[e] market." 390 U.S. at 152. It is not clear, however, why ordinary market mechanisms would not tend to correct such problems automatically. See Areeda, *supra*, ¶ 1637e. Manufacturers generally have every incentive not to hamstring their distributors, and distributors are not likely to be shy about communicating the necessary market information back to their suppliers. It therefore seems unlikely that pricing errors of this sort (which a dealer might also mitigate by offering separate service contracts) would be so frequent, so serious, or so persistent as to require per se antitrust condemnation in order to ensure effective competition.

Albrecht also adverted to the possibility that "[m]aximum price fixing may channel distribution through a few large or specifically advantaged dealers who otherwise would be subject to significant nonprice competition." 390 U.S. at 153. Again, however, a supplier normally has the economic incentive to attempt to ensure the efficiency of its distribution system, and the possibility that it may make mistakes is not enough to justify a rule that any distributor

must always be free to substitute its own, perhaps equally imperfect, judgment for that of the supplier. Indeed, after *GTE*, a vertical distribution scheme expressly designed to channel distribution through a few specific dealers, including large ones able to realize considerable economies of scale, would be evaluated under the rule of reason. Thus, the possibility that maximum prices might achieve the same effect indirectly no longer provides persuasive support for holding them per se unlawful.

Albrecht suggested (390 U.S. at 153) that "if the actual price charged under a maximum price scheme is nearly always the fixed maximum price, which is increasingly likely as the maximum price approaches the actual cost of the dealer, the scheme tends to acquire all the attributes of an arrangement fixing minimum prices." As that language itself suggests, however, it is the dealers' costs, not any restriction on maximum price, that deters price *reductions* in such circumstances. If, on the other hand, a particular vertical maximum price-fixing agreement were suspected to be, in fact, a scheme for fixing *minimum* prices, for concealing or implementing a horizontal price agreement, or for setting illegally predatory prices, then it could be challenged under the rules applicable to such arrangements. The possibility of such disguises does not pose so substantial a danger as to justify complete preclusion of legitimate, procompetitive maximum price fixing.

Finally, *Albrecht* echoed (390 U.S. at 152) the point made in *Kiefer-Stewart* (340 U.S. at 213) that all sorts of price-fixing agreements, whatever their other characteristics, "cripple the freedom of traders" by "restrain[ing] their ability to sell in accordance with their own judgment." That concern has

considerable historical resonance. See *GTE*, 433 U.S. at 66-69 (White, J., concurring in the judgment). As the Court has observed, however, every agreement concerning trade imposes some restraint on traders' freedom. *Id.* at 53 n.21, citing *Chicago Bd. of Trade* v. *United States*, 246 U.S. 231, 238 (1918). In determining which restraints are unreasonable, and therefore impermissible under the antitrust laws, "an antitrust policy divorced from market considerations would lack any objective benchmarks." *GTE*, 433 U.S. at 53 n.21. Moreover, the Court has recognized that per se rules against economically efficient vertical restraints may induce producers to take over their own distribution functions entirely, thus "work[ing] to the ultimate detriment of the small businessmen" who would otherwise operate as relatively independent distributors. *Id.* at 57 n.26; see also *Business Elec.*, 485 U.S. at 725.[10] Thus, concern for the competitive autonomy of particular market actors pro-

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[10] This is not merely speculation. See, *e.g.*, *Paschall* v. *Kansas City Star Co.*, 727 F.2d 692, 695 (8th Cir.) (en banc) (newspaper announced termination of all contract carriers in favor of delivery agents so publisher could set uniform price and provide better service), cert. denied, 469 U.S. 872 (1984); *Northwest Publ., Inc.* v. *Crumb*, 752 F.2d 473, 475 (9th Cir. 1985) (termination of distributors in favor of employee distribution in order to control subscriber prices). In other cases, a supplier barred from setting maximum resale prices may compete directly with its dealers in order to provide a constraint on their pricing. *E.g.*, *Belfiore* v. *New York Times Co.*, 826 F.2d 177, 181 (2d Cir. 1987), cert. denied, 484 U.S. 1067 (1988). Vertical integration or direct competition undertaken solely to avoid per se antitrust rules is unlikely to serve any purpose of the antitrust laws. *ARCO*, 495 U.S. at 343 n.13; see generally, *e.g.*, Blair & Fesmire, *Maximum Price Fixing and the Goals of Antitrust*, 37 Syracuse L. Rev. 43, 73 (1986).

vides neither a practical nor an analytically sound justification for holding vertical maximum price fixing to be illegal per se.

3. These arguments are typical of those advanced, over the 30 years since *Albrecht* was decided, in an extensive legal and economic literature with which this Court is doubtless familiar. See, *e.g.*, *ARCO*, 495 U.S. at 343 n.13; Areeda, *supra*, ¶¶ 1634-1638. It is fair to say that a broad consensus has developed among informed lawyers and economists that the per se rule adopted in *Albrecht* should be replaced by rule-of-reason analysis. See, *e.g.*, Areeda, *supra*, ¶ 1638b.[11] This view is shared even by a commentator who points out that rule-of-reason litigation may impose significant burdens. Pitofsky, *supra*, at 1489-1490 & n.17.[12] Moreover, the experience of those at the

[11] See also, *e.g.*, Blair & Fesmire, *Maximum Price Fixing and the Goals of Antitrust*, *supra*; *id.* at 44 ("[T]he *Albrecht* rule * * * is unambiguously negative in its effects, and judicial policy in this area should be reexamined."); Easterbrook, *Maximum Price Fixing*, 48 U. Chi. L. Rev. 886 (1981); R. Givens, *Antitrust: An Economic Approach* § 8.02[10] (1996) ("To permit antitrust laws to be used to discourage efforts to keep consumer prices *down* is to turn antitrust on its head and run counter to the basic purposes of the Sherman Act."); H. Hovenkamp, *Federal Antitrust Policy* § 11.5(c), at 422 (1994) ("Few Supreme Court decisions have proved more anticompetitive than *Albrecht*."); Areeda, *supra*, ¶ 1635; Calkins, *The October 1989 Supreme Court Term and Antitrust: Power, Access, and Legitimacy*, 59 Antitrust L.J. 339, 364 (1991) (*Albrecht* is "now generally discredited"); F. Scherer & D. Ross, *Industrial Market Structure and Economic Performance* 558 (3d ed. 1990); see also Page, *The Scope of Liability for Antitrust Violations*, 37 Stan. L. Rev. 1445, 1469-1470 (1985).

[12] Adjudication under the rule of reason does not always require elaborate and burdensome analysis. In an appropriate

Department of Justice and the Federal Trade Commission who are primarily charged with enforcement of the antitrust laws is instructive: Since *Albrecht*, we are aware of no case in which either the Commission or the United States has committed enforcement resources to proceeding against a party on the ground of purely vertical maximum price fixing.

We do not discount the possibility that there are cases in which vertical maximum price fixing may be, on balance, anti-competitive and therefore violate the Sherman Act. Repudiation of a per se rule will presumably give rise to new experience with a variety of such restraints; market participants can be creative not only in embracing competition, but in seeking to avoid it; and economists continue to explore the ways in which particular mechanisms may tend to enhance or to defeat the free operation of the market.[13] Certainly we do not advocate any rule declaring that vertical maximum pricing arrangements are per se *legal*. There is no reason to believe, however, that such anti-competitive situations will be frequent or

case, the requisite inquiry may be accomplished quickly. See *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. at 459; *National Collegiate Athletic Ass'n* v. *Board of Regents*, 468 U.S. at 110. See also Klein, *A Stepwise Approach to Antitrust Review of Horizontal Agreements*, 7 Trade Reg. Rep. (CCH) ¶ 50,157 (Nov. 7, 1996).

[13] Some recent economic literature suggests that, under certain restrictive conditions, the setting of maximum resale prices could have the effect of increasing consumer prices. See O'Brien & Shaffer, *Vertical Control with Bilateral Contracts*, 23 Rand J. Econ. 299 (1992); Perry & Besanko, *Resale Price Maintenance and Manufacturer Competition for Exclusive Dealerships*, 39 J. Indus. Econ. 517 (1991).

that those that may arise may not be adequately policed under the rule of reason. We are therefore confident that the loss of *Albrecht*'s per se rule will not materially hamper the federal government's ability to enforce the antitrust laws vigorously in any appropriate case. Compare *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 777 & n.25 (1984). In the meantime, we see no reason to deny consumers such benefits as may result from allowing suppliers to impose maximum resale prices on their distributors in situations in which such restraints are, on balance, pro-competitive.

4. "The importance of *stare decisis* is, of course, unquestioned." *GTE*, 433 U.S. at 58 n.30. In cases under the Sherman Act, however, this Court has recognized that it has a special responsibility through common-law adjudication to give more definite content to the broad mandate of the Act and, indeed, that the Act adopted the "dynamic potential * * * [of] the common law itself." *Business Elec.*, 485 U.S. at 732. The essence of that potential is the ability to adapt to changed circumstances or to the accumulation of experience. Thus, the Court has not been unwilling to reconsider previous antitrust decisions whose rationales have been called into question. See, *e.g.*, *Copperweld Corp.* v. *Independence Tube Corp.*, *supra*; *GTE*, 433 U.S. at 47-49; *Simpson* v. *Union Oil Co.*, 377 U.S. 13, 22-25 (1964) (effectively overruling *United States* v. *General Electric Co.*, 272 U.S. 476 (1926)).

In this case, although *Albrecht* effectively adopted a per se rule against vertical maximum price restraints, this Court "has never explored or analyzed in detail the justifications for such a rule," and the doctrine has played "only a relatively minor role in the Court's Sherman Act holdings" and essentially no

role in the government's enforcement efforts. *Copperweld*, 467 U.S. at 766, 777. As the *GTE* Court observed about *Schwinn*, "[s]ince its announcement, [*Albrecht*] has been the subject of continuing controversy and confusion," and "[t]he great weight of scholarly opinion has been critical of the decision." *GTE*, 433 U.S. at 47-48. Moreover, and perhaps most important, "the growth of judicial doctrine" in the area of vertical non-price restraints has largely "removed or weakened the conceptual underpinnings" of *Albrecht*. *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 173 (1989). For all these reasons, we believe that "the experience of the past [30] years should be brought to bear on this subject of considerable commercial importance." *GTE*, 433 U.S. at 48-49.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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Supreme Court of the United States
OCTOBER TERM, 1996

STATE OIL COMPANY,
Petitioner,

v.

BARKAT U. KHAN AND KHAN & ASSOCIATES, INC.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF FOR THE BUSINESS ROUNDTABLE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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---

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The Business Roundtable respectfully moves for leave to file the attached brief amicus curiae in this case. The consent of the attorney for petitioner has been obtained, but the attorney for respondents has not agreed.

The Business Roundtable is an association of more than 200 chief executive officers of leading U.S. corporations, employing over 10 million people. The CEOs examine public policy issues that affect the economy and develop positions which seek to reflect sound economic and social principles.

The companies represented in the Roundtable are engaged in a wide variety of businesses. They face substantial competition from domestic and foreign rivals, and therefore have a critical interest in the standards that are applied to judge the legality of aggressive competition

in the marketplace. In addition, many of the companies sell consumer products through independent dealers and are concerned about per se rules that inhibit service and promotional programs which benefit their ultimate consumers.

This brief is filed in support of the petitioner, but does not focus on the particular facts of this case or its immediate outcome. The brief focuses instead on the historical evolution of the law of vertical restraints. It emphasizes that *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), is a relic of the past, which has been undercut in principle and in practice by more recent decisions of this Court and of other courts. It argues that final abandonment of *Albrecht* will make an important contribution to the orderly development of the law in this area.

In short, the discussion is intended to help the Court place the present case in a broader perspective. For these reasons, The Business Roundtable requests that the following brief in support of petitioner be accepted for filing.

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---

BRIEF FOR THE BUSINESS ROUNDTABLE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

The Business Roundtable is an association of more than 200 chief executive officers of leading U.S. corporations, employing over 10 million people. The CEOs examine public policy issues that affect the economy and develop positions which seek to reflect sound economic and social principles.

The companies represented in the Roundtable are engaged in a wide variety of businesses. They face substantial competition from domestic and foreign rivals, and therefore have a critical interest in the standards that are applied to judge the legality of aggressive competition in the marketplace. In addition, many of the companies sell

consumer products through independent dealers and are concerned about per se rules that inhibit service and promotional programs which benefit their ultimate consumers.

SUMMARY OF ARGUMENT

This case inevitably presents the question whether the much-criticized decision in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), should at long last be overruled. Section I of the Argument below will show that consideration of the first antitrust injury question necessarily collapses into an inquiry about the continuing validity of *Albrecht*.

Section II of the Argument summarizes the reasons why *Albrecht* should be overruled. The underlying rationales of the *Albrecht* holding have been repudiated by this Court in later decisions, and lower courts have repeatedly struggled to avoid its anti-consumer consequences. *Albrecht*'s per se prohibition against maximum vertical price agreements nevertheless continues to inhibit business conduct that is pro-competitive and pro-consumer.

Section III of the Argument shows that repudiation of *Albrecht* will make a positive contribution in the ongoing effort to rationalize the law of vertical restraints. Efforts to accommodate the ultimate implications of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), have long distorted the law in this area. This Court has substantially reduced the distortions in recent years, and candid acknowledgment that *Albrecht* was wrong will be a significant further contribution.

ARGUMENT

I. THE ANTITRUST INJURY ISSUE HERE CANNOT BE SEPARATED FROM THE SUBSTANTIVE ISSUE.

The Roundtable agrees with petitioners and with the court below that respondents have not suffered antitrust injury under the principles announced in *Atlantic Rich-*

field Co. v. USA Petroleum Co., 495 U.S. 328 (1990), and *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477 (1977). Regardless of how the Court resolves the initial antitrust injury question,[1] however, this case squarely presents the issue whether *Albrecht*'s per se strictures against vertical maximum price fixing agreements should be retained. Indeed, in many respects, the analysis of antitrust injury collapses into the query about *Albrecht*'s continued vitality.

If the Court should hold, on the one hand, that respondents have made out a cognizable claim of antitrust injury on these facts, the continuing vitality of *Albrecht* is clearly presented for decision. Since respondents have proceeded on a per se theory, the Court's treatment of *Albrecht* becomes dispositive.

If, on the other hand, the Court should decide that respondents have not suffered antitrust injury, the ruling would inevitably raise the question of why vertical maximum price-fixing agreements are per se unlawful in the first instance. The Court has already decided that competitors bringing claims under the *Albrecht* rule lack antitrust injury unless they establish that the resulting prices are predatory. *Atlantic Richfield*, 495 U.S. 328. The

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[1] It is perhaps anomalous to consider the existence of antitrust injury before considering the substantive validity of the underlying claim. The antitrust injury requirement is not a substantive element of section 1 of the Sherman Act, 15 U.S.C. § 1, but springs from section 4 of the Clayton Act, 15 U.S.C. § 15, which confers a private right of action on persons claimed to be "injured in . . . [their] business or property by reason of anything forbidden by the antitrust laws." *Id.* at § 15(a); *see Atlantic Richfield*, 495 U.S. at 339, 342; *Brunswick Corp.*, 429 U.S. at 485. The purpose of the antitrust injury requirement is to ensure that the harm claimed by an antitrust plaintiff "corresponds to the rationale for finding a violation of the antitrust laws in the first place." *Atlantic Richfield*, 495 U.S. at 342. Therefore, in an ordered antitrust analysis, the antitrust injury inquiry occurs only after the existence of an underlying violation has been determined.

ultimate effect of *Atlantic Richfield* is to recast entirely the underlying cause of action. Even if a competitor proves the maximum resale price "agreement," it cannot recover damages without proof of a different cause of action for predatory pricing. But, predatory pricing issues are not determined by per se rules, *see, e.g., Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), and it therefore adds confusion to say that a competitor continues to have a per se claim under *Albrecht*.

Should the Court hold the dealers similarly lack antitrust injury—or suffer injury only under restricted hypothetical circumstances [2]—then the only persons left to qualify for broad per se treatment are ultimate consumers. But, here again, it is exceedingly difficult to understand how consumers will be injured in a way that justifies per se condemnation of a practice which is ordinarily designed to keep a dealer from increasing prices to them. Thus, a holding against dealer standing also undercuts the continuing utility of *Albrecht*.

II. *ALBRECHT* SHOULD BE OVERRULED BECAUSE ITS UNDERLYING RATIONALE IS NO LONGER ACCEPTED BY THIS COURT AND BECAUSE VERTICAL MAXIMUM PRICE-FIXING AGREEMENTS ARE NOT "MANIFESTLY ANTICOMPETITIVE."

Albrecht's per se prohibition of maximum vertical price fixing closely followed the Court's decision in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).[3]

[2] In *Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 19 F.3d 745, 753-54 (1st Cir. 1994), the court applied the "controversial" *Albrecht* decision, but distinguished between the factual circumstances of dealers who might or might not have standing.

[3] In *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951), the Court confronted a maximum price-fixing agreement between a manufacturer and its subsidiary. *Id.* at 212. The Court treated the two entities as competitors and thus essentially analyzed the agreement as a horizontal arrangement. *Id.* at 213 (defining the agreement in question as "an agreement *among competitors* to fix maximum resale prices of their products" (emphasis added)). Subsequent cases have also treated *Kiefer-Stewart* as an application of the per se rule to horizontal maximum price-fixing arrangements. *Arizona v. Maricopa County Med cal Soc.*, 457 U.S. 332, 348 n.18 (1982). *Albrecht*, therefore, is this Court's only decision addressing the validity of purely vertical maximum resale price fixing.

Schwinn held all vertical nonprice restraints per se unlawful if the manufacturer parted with title to the goods sold. This sweeping per se prohibition on vertical distribution restraints rested largely on three concerns, first articulated in *Dr. Miles*: (1) the Court's belief that such agreements violated the "ancient rule against restraints on alienation," *id.* at 380; (2) the notion that dealers should be free to compete in the resale market as they see fit without undue interference from the manufacturer once title has passed; and (3) the notion that a system of vertical territorial agreements between a manufacturer and its dealers had the same economic effect as a horizontal territorial agreement among dealers and thus should be treated the same.

Albrecht was a logical extension of *Schwinn*. Once *Schwinn* declared virtually all vertical nonprice restraints per se unlawful, application of the same rule to vertical maximum price restraints naturally followed.[4] Vertical price agreements, whether they set minimum or maximum prices, can be conceptualized as a "restraint on alienation" and operate to restrain a dealer's freedom in the resale market just as a vertical territorial restraint does. Similarly, if you accept the premise that the economic effect of vertical and horizontal arrangements is the same,

[4] The *Dr. Miles* Court had previously placed minimum vertical price-fixing agreements, known as resale price maintenance, in the per se category.

logic dictates that vertical price fixing be treated the same way as horizontal price fixing—the classic example of an unlawful trade restraint, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

The premises underlying *Schwinn*, and thus *Albrecht*, were explicitly rejected in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), however. Additionally, doctrinal developments since *Sylvania*—including the emphasis on antitrust injury—have so eroded *Albrecht*'s foundations that the case exists only as an empty shell. As the Seventh Circuit's opinion in this case states, the decision "should be overruled." 93 F.3d 1358, 1363.

A. This Court Has Rejected The Notion That "Restraints On Alienation" And "Dealer Freedom" Justify A Per Se Rule In Vertical Restraints Cases.

When the *Sylvania* Court overruled *Schwinn*, it rejected the fundamental premises of that decision—namely, that per se rules in the vertical restraints arena properly rest on concerns about "restraints on alienation" and other alleged infringements of "the freedom of traders . . . to sell in accordance with their own judgment." *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 213 (1951). Instead, the Court made plain that per se condemnation is reserved for those business practices that are "manifestly anticompetitive." *Sylvania*, 433 U.S. at 50. This stringent standard displaced *Schwinn*'s formalistic concerns with a clear focus on the economic effects of the practice in question. *Id.* at 58-59 ("[D]eparture from the rule-of-reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing"). Under the *Sylvania* standard, categorical proscription of business behavior is appropriate only when the practice "facially appears to be one that would always or almost always tend to restrict competition and decrease output." *Broadcast*

Music, Inc. v. Columbia Broadcasting Sys., 441 U.S. 1, 19-20 (1979).

The analytical significance of the shift from *Schwinn* to *Sylvania* cannot be overstated. One of *Sylvania*'s central insights is recognition that a decision to apply a per se rule itself reflects a judgment on the economic utility of all forms of a particular business practice. *Sylvania*, 433 U.S. at 50 n.16 ("Per se rules . . . require the Court to make broad generalizations about the social utility of particular commercial practices"). In deciding whether certain behavior should be categorically proscribed, ancient rules about "restraints on alienation" and rhetoric about "dealer freedom" simply do not answer the relevant questions.

Undoubtedly, all vertical agreements restrain intrabrand competition and in some cases, like the grant of an exclusive territory, completely eliminate it. But that fact alone says nothing about whether the elimination of certain types of rivalry increases output, improves services, or otherwise benefits consumers. Accordingly, when the Court overruled *Schwinn*, it held as a necessary corollary that vertical reductions of intrabrand competition were justifiable if they enhanced other forms of competition. *See id.* at 52 n.19 (drawing a distinction between interbrand and intrabrand competition and labeling the former "the primary concern of antitrust law"). Since *Albrecht* rests on the same premises as *Schwinn*, the *Sylvania* Court's repudiation of *Schwinn* jettisoned the underlying rationale for *Albrecht* as well.

B. The Court Has Also Rejected The Notion That The Economic Effects Of Vertical And Horizontal Agreements Are Identical And Require Equivalent Antitrust Treatment.

At the time it rendered its decisions in *Schwinn* and *Albrecht*, the Court still adhered to the view that vertical and horizontal agreements had equivalent economic effects and therefore warranted similar treatment under the anti-

trust laws. A series of purely vertical agreements between a manufacturer and its dealers was thought to reduce intraband competition in a manner similar to a horizontal agreement among dealers. Subsequent economic studies substantially undercut that view. Empirical and theoretical analyses demonstrated that vertical restraints can stimulate interbrand competition precisely because they suppress some of the most deleterious effects of unrestrained intrabrand competition, such as free riding, and encourage the provision of a wide range of promotional services to consumers. By drawing a distinction betwen interbrand and intrabrand competition, *Sylvania* gave legal expression to that learning, 433 U.S. at 54-57 (citing numerous economic articles identifying the potential pro-competitive benefits resulting from vertical nonprice restraints).

Since *Sylvania*, the Court has expressly made clear that there is no equivalence between the scope of the per se rule as it applies to certain horizontal restraints and as it applies or should apply to vertical agreements. *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 734 (1988) (the "notion of equivalence between the scope of horizontal *per se* illegality and that of vertical *per se* illegality was explicitly rejected in *GTE Sylvania*. . . ."). [5] For example, *Sylvania* requires that vertical territorial agreements be judged under the rule of reason, while horizontal ones are normally per se unlawful. *See, e.g., Palmer v. BRG of Ga.*, 498 U.S. 46 (1990). [6]

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[5] The distinction actually pre-dates *Sylvania*, in some areas. *Compare, e.g., United States v. Container Corp. of Am.*, 393 U.S. 333 (1969) (barring mere exchanges of price information at the horizontal level) *with Susser v. Carvel Corp.*, 332 F.2d 505 (2d Cir. 1964) (upholding the circulation of suggested resale prices to customers), *cert. dismissed*, 381 U.S. 125 (1965).

[6] This recognized distinction between horizontal and vertical agreements is the reason why the Court's decision in *Arizona v. Maricopa County Medical Soc.*, 457 U.S. 332 (1982), is not controlling.

Moreover, while retaining the per se rule against minimum resale price maintenance, the Court has carefully circumscribed the cases to which it is applicable so that the *Sylvania*'s application of the rule of reason to vertical nonprice restraints will not be circumvented by recharacterization of those practices as vertical price agreements. *See, e.g., Sharp*, 485 U.S. 717 (1988) (holding that agreement between manufacturer and one dealer to terminate a second dealer because of the second's discounting is subject to analysis under the rule of reason unless the manufacturer and remaining dealer also agree on resale prices or price levels).

In addition, the Court has been "solicitous to assure that the market-freeing effect of [its] decision in *GTE Sylvania* is not frustrated by related legal rules." *Id.* at 726. In *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984), the Court articulated strict standards for inferring vertical price agreements from ambiguous evidence. Thus, both *Monsanto* and *Sharp* recognize that the scope of the per se rule in the vertical restraints arena should be "narrow," *Sharp*, 485 U.S. at 724, and calibrate the standards for the other elements of a Sherman Act violation in order to protect that fundamental principle.

Finally, the Court has circumscribed those situations in which private plaintiffs may recover treble damages for injuries allegedly flowing from maximum vertical price agreements. In *Atlantic Richfield*, the Court flatly prohibited any competitor from obtaining damages for a violation of the *Albrecht* rule in the absence of a showing that the agreed upon maximum price is predatory. The effect of this decision is to further gut the *Albrecht* rule. [7] By limiting the circumstances in which competitors may

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[7] The *Atlantic Richfield* decision acknowledges this point by noting that, for purposes of that decision, the Court simply "assume[d], *arguendo*, that *Albrecht* correctly held that vertical, maximum price-fixing is subject to the *per se* rule." 495 U.S. at 335 n.5.

recover for maximum vertical price agreements, the Court has effectively shifted the focus away from *Albrecht*'s per se strictures and placed upon the competitor the demanding burden of proving a conspiracy between a manufacturer and its dealer or dealers to price predatorily. Because predatory pricing schemes are rare and unlikely to succeed, *see Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588-89 (1986), the Court's holding in *Atlantic Richfield* is an implicit recognition that maximum vertical price agreements are unlikely to cause substantial competitive harm in many contexts.

C. Lower Courts Have Also Consistently Limited *Albrecht* In Order To Avoid The Anti-Consumer Consequences Of A Rigid Adherence To Its Per Se Prohibitions.

Faced with a decision based on logical premises which this Court has subsequently repudiated, the lower courts have repeatedly limited the reach of *Albrecht*'s per se rule by resort to alternative legal theories. Several courts have held, for example, that it is not vertical price fixing when a manufacturer and dealer agree that the dealer will pass on a promotional discount to consumers but do not agree on the underlying price level. *Lattice Semiconductor Corp. v. Interface Elec. Corp.*, 1994-2 Trade Cas. (CCH) ¶ 70,779 (9th Cir.); *Jack Walters & Sons Corp. v. Morton Bldg., Inc.*, 737 F.2d 698 (7th Cir.), *cert. denied*, 469 U.S. 1018 (1984); *Lewis Serv. Center, Inc. v. Mack Trucks, Inc.*, 714 F.2d 842 (8th Cir.), *cert. denied*, 467 U.S. 1226 (1983); *AAA Liquors, Inc. v. Joseph E. Seagram & Sons, Inc.*, 705 F.2d 1203 (10th Cir. 1982), *cert. denied*, 461 U.S. 919 (1983). Lower courts have also based their decisions on the plaintiff's failure to prove antitrust injury, *Jack Walters & Sons*, 737 F.2d at 708-09; lack of a causal link between the presumed injury to competition and plaintiff's alleged injury, *Northwest Publications, Inc. v. Crumb*, 752 F.2d 473 (9th Cir. 1985); or lack of an actual "agreement"

between the manufacturer and dealer, *Curry v. Steve's Franchise Co.*, 1985-2 Trade Cas. (CCH) ¶ 66,877 (D. Mass); *Martindell v. News Group Publications, Inc.*, 621 F. Supp. 672 (E.D.N.Y. 1985).

Even when lower courts have applied the *Albrecht* rule, they have recognized that the decision is difficult to reconcile with subsequent authority. In this action, for example, the court stated that *Albrecht* was "unsound *when decided*, and is inconsistent with later decisions by the Supreme Court." 93 F.3d at 1363 (emphasis added). Similarly, in *Caribe BMW, Inc. v. Bayerische Motoren Werke Akitengesellschaft*, 19 F.3d 745 (1st Cir. 1994), the First Circuit recognized that *Albrecht* is a "controversial case," outlawing "not only anticompetitive uses of maximum price fixing, but also procompetitive uses as well, namely, use of a maximum resale price agreement that protects consumers from the exercise of a retailer's monopoly power." *Id.* at 753 (citing 8 PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1636 (1989)). *Caribe* is thus far from a ringing endorsement of the *Albrecht* rule, but rather stands for the proposition that—as long as *Albrecht* remains the law—lower courts will not be able to dispose of dealer claims of maximum vertical price fixing on antitrust injury grounds at the pleading stage.

D. Maximum Vertical Price Agreements, Like Vertical Nonprice Agreements, Can Have Substantial Procompetitive Effects.

Since the stated rationales for the *Albrecht* rule have passed into antitrust antiquity, the rule can survive only if it satisfies *Sylvania*'s "manifestly anticompetitive" standard. Accordingly, the Court should retain the *Albrecht* rule only if it can be said that, on their face, maximum vertical price agreements always or almost always reduce market output. *Cf. Broadcast Music, Inc.*, 441 U.S. at 19-20. It is plain that such agreements do not meet that standard.

The potential procompetitive effects of vertical nonprice restraints, which the Court recognized in *Sylvania*,

may also result from or be enhanced by maximum vertical price agreements. Exclusive dealer territories, for example, may be the most efficient mode for distribution of a manufacturer's product. Exclusive arrangements are not per se unlawful, but may result in localized monopolies or permit some dealers to exercise a degree of market power. Like any monopolist or seller with market power, the local dealer may raise prices and restrict output. This harms both consumers, who must pay higher prices for a product, and manufacturers, who make fewer sales. A maximum price agreement benefits both manufacturer and consumer by controlling any dealer's exercise of market power. *See* AREEDA, *supra*, ¶ 1636a.

It makes no sense to condemn out of hand a practice which is designed to *prevent* reductions in output and increased prices at the dealer level. Moreover, since the Court has recognized the efficiencies flowing from exclusive territorial arrangements, it also makes no sense to categorically prohibit ancillary and related practices that limit the possible adverse impact of the permitted distribution system.

Maximum price agreements can be pro-competitive and pro-consumer even when dealers are not given exclusive territories. Manufacturers frequently have special promotional programs to build market share or reduce inventory. This can be done with direct consumer coupons or rebates, or by relying on the dealer to pass through the benefits of the promotion to consumers. If the dealer instead pockets part of the benefits, the output-enhancing effect may be dampened—but efforts to prevent dealers from doing so can be attacked as violative of *Albrecht*.[8]

[8] There are further practical complexities when there are jointly financed promotions by manufacturers and dealers, and joint advertising of these promotions. As long as the *Albrecht* precedent stands, antitrust counselors have to focus on formalistic distinctions rather than practical effect.

The fundamental flaw in *Albrecht* is illuminated if you view vertical relationships as the purchase of services by the manufacturer rather than the purchase of goods by the retailer. It then becomes obvious, first, that vertical restrictions are highly unlikely to be in aid of horizontal ones, since a buyer (here the manufacturer) normally has no interest in facilitating a supplier cartel.

In addition, if you say that a manufacturer can never specify the maximum dealer margin, you are saying that a buyer can never put a limit on what it is willing to pay for services it buys. The fact that a dealer might like to sell an enhanced package of services, and even thinks it has customer demand for those services, does not mean it should be per se illegal for a manufacturer to decide it does not want to pay for that enhanced package.

The final irony is that the *Albrecht* rule does nothing to protect the very dealers for whom the opinion professes solicitude. To the extent that *Albrecht* inhibits manufacturers' efforts to protect their ultimate customers from exploitation, or to extend promotional benefits to them, it creates perverse incentives for manufacturers to integrate vertically into distribution to the detriment of dealers. AREEDA, *supra* ¶ 1635. This internal contradiction should be eliminated by abandonment of *Albrecht*'s per se rule.

E. The Possibility That Vertical Maximum Price Agreements Might, In Some Circumstances, Become Minimum Price Arrangements Does Not Justify Continued Application Of The Per Se Rule.

Although *Albrecht* expresses a fear that maximum vertical price agreements may be disguised minimum resale price maintenance arrangements, that possibility does not justify application of the per se rule under *Sylvania*'s "manifestly anticompetitive" standard. Since *Sylvania*, the Court has simply refused to find that the mere possibility an agreement might work competitive harm is sufficient to

make it categorically unlawful. Indeed, such a sweeping use of per se rules is precisely what *Sylvania* rejects.

Sylvania endorses the rule of reason as the standard mode of antitrust analysis and places the burden on those who would depart from it. *Sylvania*, 433 U.S. at 58-59. It does so because the rule of reason provides an opportunity to separate competitively beneficial or neutral practices from those that cause real consumer injury. Overruling *Albrecht*, therefore, does not shield vertical maximum price agreements from antitrust scrutiny but merely subjects them to the standard rule of reason review, which balances the competitive benefits of the practice against any harms.

Albrecht is a product of its times in a number of respects—some already mentioned. It is also important that the rule of reason had little substantive content when *Albrecht* was decided. Apart from the vague and generalized inquiry described in *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918), the rule of reason provided no structured analytical framework for resolution of antitrust issues. At the time *Albrecht* was decided, adoption of the rule of reason in effect constituted a determination that the practice was lawful. Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 Geo. L.J. 305 (1987). The same cannot be said today.

Economic analysis in general and judicial facility with economic analysis in particular have given substantive content and precise focus to the rule of reason since *Sylvania*. *See, e.g., FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986) (applying rule of reason and declaring horizontal agreement among competitors unlawful); *NCAA v. Board of Regents*, 468 U.S. 85 (1984) (applying rule of reason to declare agreement among competing colleges and universities to reduce the number of televised college football games unlawful). Both this Court and

the lower courts have developed "quick look" applications of the rule of reason, *e.g., Indiana Fed'n of Dentists; NCAA; National Society of Professional Eng'rs v. United States*, 435 U.S. 679 (1978); *Chicago Professional Sports Ltd. Partnership v. National Basketball Ass'n*, 961 F.2d 667 (7th Cir.), *cert. denied*, 506 U.S. 954 (1992), and applied "screening" devices, such as market power tests, to reduce the cost and burden of applying the rule of reason while retaining the benefits of rule of reason analysis, *e.g., Rothery Storage & Van Co. v. Atlas Van Lines*, 792 F.2d 210, 221 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1033 (1987); *Graphic Prods. Distribs., Inc. v. Itek Corp.*, 717 F.2d 1560, 1568-69 (11th Cir. 1983). These efforts have been reinforced by guidelines of governmental enforcement agencies that focus antitrust inquiries on relevant economic issues and provide a refined analytical structure. *See, e.g., Department of Justice and Federal Trade Commission Horizontal Merger Guidelines* (1992).

A rule of reason inquiry, therefore, is no longer formless and open-ended. Abolition of *Albrecht* does not mean that harmful vertical maximum price agreements will escape condemnation under the Sherman Act. Always is not the only alternative to never.

III. THE CONTINUING EFFORT TO BRING ECONOMIC RATIONALITY TO THE LAW OF VERTICAL RESTRAINTS WILL BE ADVANCED BY A CANDID RECOGNITION THAT *ALBRECHT* IS AN ANACHRONISM.

As suggested above, this Court no longer applies the underlying premises of the *Dr. Miles* decision. *Dr. Miles* was based on the medieval prohibition against restraints on alienation and the idea that vertical restraints are equivalent to horizontal restraints. Neither idea has been accepted since *Sylvania*. This Court can therefore simply

overrule *Albrecht* on the basis of existing, more recent precedent.[9]

It is, however, also useful to understand that final interment of *Albrecht* will make a positive contribution to the evolution of vertical restraints law. It was apparent, almost from the start, that the *Dr. Miles* principles would cause serious harm if pressed to their logical conclusion. Since the consequences of finding a vertical price "agreement" were unrelentingly severe under these principles, courts began to focus on the issue of whether there was an agreement rather than on the economic consequences of the practice. Thus, *United States v. Colgate & Co.*, 250 U.S. 300 (1919), upheld the right of a manufacturer to announce a resale pricing policy and refuse to do business with distributors who departed from it. The decision vindicated the basic right of suppliers to choose their customers, but it required some distortion of ordinary principles of contract law, which recognize "agreements" based on performance.

The Court then drastically narrowed the reach of the *Colgate* doctrine by finding that it did not apply if there was "affirmative action to achieve uniform adherence" to a manufacturer's resale price policy. *United States v. Parke, Davis & Co.*, 362 U.S. 29, 47 (1960). This limitation was justified in part by the fact that the affirmative action included enforcement assistance from other dealers —*i.e.*, there were "agreements" with third parties. But, the Court also made the curious distinction between "voluntary acquiescence" by dealers, which is presumably benign, and a manufacturer's interference with the dealer's individual free choice. *Id.* at 46-47. In other words,

[9] It is possible to support the holding in *Dr. Miles*, and still argue that *Albrecht* is wrong. *See, e.g.*, Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1490 n.17 ("Maximum vertical price fixing . . . probably *should* be treated under a rule of reason.").

evidence of fundamental *disagreement* makes the situation worse.[10]

The same curious distinction is imbedded in the so-called "consignment" exception to *Dr. Miles*. In *United States v. General Elec. Co.*, 272 U.S. 476 (1926), the Court upheld a resale price maintenance plan by a seller who retained title to its products but consigned them to agents for resale. The later decision in *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964), distinguished *General Electric* in part on the ground that the defendant's widespread consignment arrangements involved pernicious "coercion" of dealers. Again, evidence of disagreement apparently made the illegal "agreement" worse.

The irony of the distinctions in these cases is more than purely semantic. Recall that *Dr. Miles* was based on the assumption that vertical price arrangements were equivalent to horizontal agreements among dealers, and there is a scholarly consensus among both defenders and critics of *Dr. Miles* that the principal potential problem with vertical price arrangements is the possibility that they may facilitate a dealer cartel.[11] Yet, under existing precedent, evidence that tends to *negate* the existence of a dealer cartel—*i.e.*, evidence that the restraint is manufacturer driven and contrary to dealer interests—is cited in aggravation rather than mitigation.

[10] This anomaly is responsible for the conventional wisdom among experienced corporate counselors that a *Colgate* resale price program is safe as long as 100 percent of the dealers are happy with it, and only becomes dangerous when mavericks emerge.

[11] *Compare* Pitofsky, *supra* note 9, at 1490-91 *with* ROBERT H. BORK, THE ANTITRUST PARADOX 292 (1978); *see also* Edward Meadows, *Bold Departures in Antitrust*, FORTUNE, Oct. 5, 1981, at 180, 182 (quoting William Baxter, the former Assistant Attorney General in charge of the Antitrust Division, as stating that "[a] vertical problem is either a horizontal problem in disguise or no problem at all").

The basic distinction between "price" and "nonprice" restraints also is based on the authority of *Dr. Miles*, rather than practical reality. In *Sylvania*, the Court for the first time applied sophisticated economic analysis to the law of vertical restraints. In a famous footnote, however, the Court expressly reaffirmed the use of per se analysis for vertical price restraints. *Sylvania*, 433 U.S. at 51 n.18. The distinction is artificial. All vertical restraints, if effective, will have an effect on price—and direct price restrictions are not necessarily the most severe. A dealer price restriction, for example, may blunt one aspect of intraband competition; an exclusive territory restriction may extinguish intrabrand competition altogether.

Faced with the dramatic consequences of a semantic distinction between "price" and "nonprice" vertical restrictions, lower courts have sometimes had to stretch hard to avoid placing price-related restrictions in the per se category. *See, e.g., Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir.) (resale price restriction on sales outside dealer's designated area not illegal per se because territorial exclusivity could have accomplishd the same thing), *cert. denied*, 439 U.S. 833 (1978); *see also supra* at 10-11 (citing decisions in which courts are forced to draw formalistic lines in order to uphold the legality of manufacturer efforts to ensure that discounts to dealers are passed through to customers).

In short, the *Sylvania* case and its progeny have made a dramatic contribution to consumer welfare by liberating the competitive system from archaic doctrines that distorted the law of vertical restraints. But some legal anachronisms remain[12] because of the long shadow cast by the misguided and subsequently repudiated premises of *Dr.*

[12] Compare the continuing fiction that tying arrangements are per se illegal, although an extensive market analysis is necessary to trigger application of the rule. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984).

Miles. The Court has been committed to progress by increments—and this brief does not urge another course—but it is important to recognize that there still are problems of internal coherence and consistency. This case provides the opportunity to reduce further the reach of those problems.

For the reasons stated, there is nothing of *Albrecht* that is worth preserving. This Court should flatly overrule *Albrecht* as part of its continuing effort to introduce economic reality into antitrust enforcement.

CONCLUSION

This Court should accept the overt invitation of the court below, and reverse.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY, *Petitioner,*

v.

BARKAT U. KHAN and KHAN & ASSOCIATES, *Respondents.*

On Writ of Certiorari to the
United States Court of Appeals for the Seventh Circuit

BRIEF FOR THE COALITION FOR FAIR CONSUMER PRICING, AS *AMICUS CURIAE* SUPPORTING PETITIONER

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Burger King Corporation
Dresser Industries, Inc.
Dunkin' Donuts, Inc.
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The Southland Corporation
TCBY Enterprises, Inc.
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INTEREST OF THE *AMICUS CURIAE*

The Coalition For Fair Consumer Pricing ("Coalition") respectfully submits this brief as *amicus curiae* pursuant to Rule 37 of the Rules of the Supreme Court. The Coalition supports the petitioner's position that the agreement between petitioner and respondents should not be a *per se* violation of the Sherman Act, 15 U.S.C. § 1 *et seq.* (1994).

The Coalition is an organization formed for the purpose of submitting this *amicus* brief. The Coalition's membership consists of a broad cross-section of corporate America, including both small and large manufacturing, retailing, and franchising companies. The members of the Coalition are: AFC Enterprises, Inc. (owner of the Popeyes Chicken & Biscuits and Church's Chicken franchise systems); Allied-Domecq Retailing International (owner of Dunkin' Donuts, Inc. and Baskin-Robbins Incorporated); Brinker International, Inc.; Burger King Corporation; Dresser Industries, Inc.; Eastman Kodak Co.; General Motors Corp.; The Goodyear Tire & Rubber Company; Great American Cookie Company, Inc.; Harley-Davidson Motor Co.; Koch Industries, Inc.; Konica Business Machines U.S.A., Inc.; Midas International Corporation; Miller Brewing Co.; Milliken & Company; Motel 6 Operating L.P.; Norwalk Furniture Corporation; PACCAR Inc.; The Pillsbury Company; Saab Cars USA, Inc.; Sears, Roebuck & Co.; The Stroh Brewery Company; The Southland Corporation; TCBY Enterprises, Inc.; The Toro Company; and Wendy's International, Inc.

The Coalition's interest in this case stems from the concern of its members that the current *per se* prohibition on maximum vertical price fixing agreements deprives consumers of the full benefit of vigorous interbrand competition among providers of goods and services. The

automatic prohibition on maximum vertical price fixing forces the members to use marketing and distribution practices which are less effective and more costly to implement than maximum vertical price fixing agreements. Accordingly, the Coalition and consumers have a vital interest in abolishing the *per se* prohibition on maximum vertical price fixing, and in having the legality of maximum vertical price fixing agreements evaluated on a case-by-case basis under the rule of reason approach.

SUMMARY OF THE ARGUMENT

The Court is presented in this case with an opportunity to modify an antitrust principle with which businesses, judges, and academics have struggled since it was first established in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). The *per se* rule against maximum vertical price fixing agreements prevents manufacturers and other upstream suppliers from imposing a price ceiling on their dealers, franchisees, distributors, and other downstream resellers. As a result, upstream suppliers are prohibited from engaging in a practice that would tend to result in *lower* prices to consumers. This outcome is the antithesis of what the antitrust laws were designed to accomplish -- an increase in competition resulting in lower consumer prices.

The legality of most trade restraints is determined by applying the rule of reason analysis, which considers the actual effects of the restraint; only the most pernicious conduct is condemned without the benefit of an analysis of the effects of the conduct in the market. Maximum vertical price fixing is not pernicious, and the Court, in the years since *Albrecht*, has recognized that maximum vertical price fixing has procompetitive effects. Indeed, antitrust scholars and commentators are virtually unanimous in their

conclusion that the significant procompetitive effects of maximum vertical price fixing justify applying the flexible rule of reason approach to this practice.

The problems with the *per se* prohibition on maximum vertical price fixing are most evident in franchise and dealership systems, where consumers have come to expect uniformity of the essential features (such as service and promotional pricing) among franchisees/dealers operating under a common trademark. Because maximum vertical price fixing has been treated as *per se* unlawful, upstream suppliers have had to resort to other, less efficient, methods to restrain potential overcharging by their dealers. These other methods, while lawful, are often impracticable and insufficient to benefit consumers. Moreover, these methods result in higher distribution costs throughout the United States.

For all of these reasons, maximum vertical price fixing arrangements should be analyzed under the rule of reason approach.

ARGUMENT

MAXIMUM VERTICAL PRICE FIXING SHOULD NOT BE *PER SE* UNLAWFUL.

The main issue in this case -- whether maximum vertical price fixing should remain *per se* unlawful, or whether its competitive effects should be analyzed under the rule of reason -- is one which should be resolved in favor of the rule of reason standard. The *per se* prohibition on maximum vertical price fixing has been almost universally criticized by antitrust and industrial organization scholars. Even assuming that *per se* liability were justified in the past

based on the best information then available to the Court, it now should be clear that neither economic theory nor empirical evidence can support the continued application of the *per se* standard in this context. For this reason, the Seventh Circuit in this case, while finding itself compelled to follow the *per se* standard enunciated in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), made it clear that *Albrecht* "should be overruled." *Khan v. State Oil Co.*, 93 F.3d 1358, 1363 (7th Cir. 1996). The Coalition urges this Court to follow the Seventh Circuit's recommendation and apply the more flexible rule of reason standard to maximum vertical price fixing agreements.

I. The Court Should Overrule *Albrecht*.

The *Albrecht* case "is the only case in which the Court has confronted an unadulterated vertical, maximum price-fixing arrangement" and ruled on the legality of that practice. *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 336 n.6 (1990). The application of the *per se* standard in *Albrecht* does not fit within the Court's traditional antitrust jurisprudence and is an anomalous decision that the Court should now rectify.

The Court has consistently emphasized that the favored standard for assessing the legality of most restraints of trade is the rule of reason, which permits an analysis of the actual effect of the restraint (procompetitive, anticompetitive, or neutral) on competition. *See, e.g., Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723, 726 (1988) ("Ordinarily, whether particular concerted action violates § 1 of the Sherman Act is determined through case-by-case application of the so-called rule of reason . . . [T]here is a presumption in favor of a rule-of-reason standard"). The *per se*, or automatic,

condemnation of a practice should occur "only for conduct that is manifestly anticompetitive . . . that is, conduct that would always or almost always tend to restrict competition and decrease output." *Id.* at 723 (citations and quotations omitted). The Court has observed that, especially when reviewing vertical restraints, "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977).

Whatever the reasoning may have been in the past, today the application of a *per se* liability standard to maximum vertical price fixing can be viewed only as "formalistic line drawing." This Court has expressly recognized the procompetitive aspects of maximum vertical price fixing. In *Atlantic Richfield Co. v. USA Petroleum Co.*, the Court conceded that, at least in the context of exclusive territories assigned to dealers (who might be able to exploit consumers by acting as local monopolists within their territories), "[t]he procompetitive potential of a vertical maximum price restraint is more evident now than it was when *Albrecht* was decided, because exclusive territorial arrangements and other nonprice restrictions were unlawful *per se* [when *Albrecht* was decided] in 1968. . . . These [exclusive territory] agreements are currently subject only to rule-of-reason scrutiny, making monopolistic behavior by dealers more likely." 495 U.S. at 343 n.13. The Court concluded its recent analysis of maximum vertical price fixing by noting eight commentators who "have identified procompetitive effects of vertical, maximum price fixing." *Id.*

Following this analysis, the Court of Appeals for the Seventh Circuit in this case stated that the continued validity

of *Albrecht* is an open question because, after *Albrecht*, this Court reversed its previous view of exclusive dealer territories, recognizing that they might be procompetitive (citing *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36). The Seventh Circuit noted that "a price ceiling is a natural and procompetitive incident to a scheme of territorial exclusivity," and that, now that territorial exclusivity is a common practice and no longer *per se* unlawful, the imposition of a price ceiling certainly should not be subject to a standard of automatic illegality. *Khan v. State Oil Co.*, 93 F.3d at 1363.

The *per se* prohibition of maximum vertical price fixing is not a rule that is deeply embedded in antitrust jurisprudence. Nor is it a rule that has much support in the academic community. Moreover, the lower courts increasingly are analyzing a variety of pricing practices under a rule of reason.[1/] The Court should recognize the modern thinking by permitting the lower courts to evaluate the competitive effects of maximum vertical price fixing on a case-by-case basis -- *i.e.*, under a rule of reason analysis.

II. Economic Theory Does Not Support the Application of a Rule of *Per Se* Illegality to Maximum Vertical Price Fixing.

The *per se* condemnation of maximum vertical price fixing has little economic justification. Many antitrust scholars and economists have concluded that maximum vertical price fixing is, at worst, competitively neutral and, at best, procompetitive. The procompetitive justification for

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[1/] For a discussion of the trend in favor of a rule of reason analysis, see notes 3-8 *infra*.

this practice is based on the recognition that, in a competitive market, there is a competitive level of price markups that is possible when goods are distributed from upstream suppliers through dealers or distributors to consumers. The total price markup is divided between the upstream supplier's markup and the dealer's markup. When there is imperfect competition -- such as when the dealer has an exclusive territory, the product being distributed is distinctive, the consumer has imperfect information about prices at other locations, or the consumer has transport costs in traveling to or receiving the product from other locations -- the dealer is able to exercise a form of market power by raising prices above the competitive level. By establishing a price ceiling for its dealers, the upstream supplier is able to prevent its dealers from fully exploiting their superior position at the expense of consumers and the upstream supplier. Thus, by imposing a maximum resale price on its dealers, an upstream supplier is able to alleviate the problem of "double marginalization" or "successive monopolies," thereby resulting in lower prices to consumers and a higher volume of sales. *See Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. at 343 n.13; *Albrecht v. Herald Co.*, 390 U.S. at 157-58 (Harlan, J., dissenting); *Khan v. State Oil Co.*, 93 F.3d at 1362; Phillip E. Areeda, 8 Antitrust Law ¶ 1634 (1989); Roger D. Blair, *The Ghost of Albrecht: Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 40 Antitrust Bull. 205, 212-17 (1995); Kevin J. Arquit, *Resale Price Maintenance: Consumers' Friend or Foe?*, 60 Antitrust L. J. 447, 462-63 (1992); Roger D. Blair & Gordon L. Lang, *Albrecht After ARCO: Maximum Resale Price Fixing Moves Toward the Rule of Reason*, 44 Vand. L. Rev. 1007 (1991); Martin K. Perry & David Besanko, *Resale Price Maintenance and Manufacturer Competition For Exclusive Dealerships*, 39 J. Indus. Econ. 517 (1991).

This Court explained the benefits of maximum vertical price fixing in *Atlantic Richfield Co. v. USA Petroleum Co.*, where it stated that maximum vertical price fixing tends to "drive prices toward the level that would be set by intense competition, by prevent[ing] retailers or wholesalers from reaping monopoly or supercompetitive profits." 495 U.S. at 343 n.13 (quotations and citations omitted). Professor Areeda, who concluded that "*Albrecht's per se* condemnation of vertical price ceilings rests on unsupportable premises," Areeda, *supra*, at ¶ 1639, provides a clear and simple justification for allowing maximum vertical price fixing:

> A dealer, although small in absolute terms, may enjoy a considerable degree of monopoly power in its local market. Like any other monopolist, it is likely to restrict output and raise price, to the detriment of both the manufacturer and consumer. The detriment to the consumer is obvious: higher prices. The detriment to the manufacturer is equally clear: fewer sales. The manufacturer thus serves both his own interests and those of consumers by restraining the dealers' exercise of monopoly power and preventing dealers from profiting more than necessary for effective performance of the distribution function. This protects the public from price gouging.

Id. at ¶ 1636a.

Despite the widespread acceptance of this procompetitive analysis, the Court thus far has declined expressly to overrule the *per se* standard. In *Albrecht*, the

Court identified three anticompetitive possibilities that led it to criticize the practice of maximum vertical price fixing: (1) the price ceiling might be set too low for dealers to furnish necessary services; (2) sales might be channeled through only a few large or advantaged dealers; and (3) the practice might acquire the attributes of, or be used as a subterfuge for, an arrangement fixing minimum prices. *Albrecht v. Herald Co.*, 390 U.S. at 152-53; *see also Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. at 335-36. These concerns repeatedly have been addressed and dismissed by many authorities. *See, e.g.*, Areeda, *supra*, at ¶ 1635; John E. Lopatka, *Stephen Breyer and Modern Antitrust: A Snug Fit*, 40 Antitrust Bull. 1, 59-60 (1995); Blair, *supra*, at 218-20. As to the first anticompetitive possibility, it is not in the economic interest of an upstream supplier to set a price cap so low that retailers could not provide desirable services. In response to the second anticompetitive concern, it is not necessarily the case that larger retailers operate with greater efficiency than smaller, specialty shops; in any event, consumers are not likely to be injured if only the most efficient retailers survive. As to the third anticompetitive theory, if a maximum vertical price fixing agreement actually is a minimum vertical price fixing agreement in disguise, it will be governed by the standards applicable to minimum vertical price fixing.

In addition to these three theories of anticompetitive behavior, there is a concern that vertical price fixing (both maximum and minimum) could be used as a means of facilitating horizontal collusion among upstream suppliers or

dealers.[2] *See, e.g., Khan v. State Oil Co.*, 93 F.3d at 1367-68 (Ripple, J., concurring). According to the upstream collusion theory, vertical price fixing is used by upstream suppliers to establish a collusive wholesale price. By requiring members of the cartel to impose price restraints on their dealers, the upstream suppliers have an effective method of detecting cheating by the other cartel members. According to the dealer collusion theory, dealers induce their suppliers to enforce a collusive price through vertical price fixing. The dealers then are able to detect cheating and discipline dealers who cheat on the resale price. Recent empirical studies, however, demonstrate that horizontal collusion is not a significant explanation of vertical price fixing agreements. Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against The Corning Glass Works*, 39 J. L. & Econ. 285 (1996); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence From Litigation*, 34 J. L. & Econ. 263 (1991).

Even if particular instances of maximum vertical price fixing might have anticompetitive effects, the rule of reason is the standard of analysis that is best equipped to assess those effects and to balance them against the procompetitive effects of maximum vertical price fixing that courts and commentators have recognized. "The alleged evils of maximum resale price limitations are either illusory or can be appropriately handled without *per se* condemnation." Areeda, *supra*, at ¶ 1635.

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[2] Agreements on price between or among competitors at either the upstream supplier or dealer level (*i.e.*, horizontal agreements) are, of course, *per se* offenses.

III. The *Per Se* Condemnation of Maximum Vertical Price Fixing Is Particularly Unsound When Applied To Franchise and Dealership Relationships.

For members of the Coalition who operate franchise and dealership networks, the application of a *per se* rule of illegality is particularly troublesome because the procompetitive benefits of maximum vertical price fixing are more pronounced in this context. *See generally* Roger D. Blair & Amanda K. Esquibel, *Maximum Resale Price Restraints in Franchising*, 65 Antitrust L. J. 157 (1996); Michael L. Denger, *Resale Pricing Issues In Distribution and Franchisor Operations*, 60 Antitrust L. J. 419 (1991). Franchisors frequently engage in system-wide, or at least regional, price promotions, and consumers have come to expect uniformity of the essential features in franchises generally. At least one court has recognized the importance of uniform pricing in franchise systems by holding that a franchisor has a legitimate interest in maintaining the credibility of its advertised promotional price, and that it, accordingly, "must be allowed to take reasonable measures to make sure the advertised price is not exceeded." *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698, 708 (7th Cir.), *cert denied*, 469 U.S. 1018 (1984).

In franchise and dealership systems, it is common for franchisees/dealers to benefit from exclusive territories or marketing areas. Additionally, franchise and dealership systems generally operate under distinctive trademarks. To discourage dealers from exercising the marketing power which is the product of the above factors, upstream suppliers have employed a myriad of approaches to influence, but not control, dealer pricing. These marketing approaches have

included price restrictive cooperative advertising programs[3], direct price advertising[4], price supports and

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[3] Price restrictive cooperative advertising programs entail the granting of cooperative advertising payments or other compensation by an upstream supplier to dealers who advertise the upstream supplier's suggested retail price or no price at all. In *Nissan Antitrust Litigation*, 577 F.2d 910 (5th Cir. 1978), *cert. denied*, 439 U.S. 1072 (1979), the Fifth Circuit affirmed a jury verdict upholding, under the rule of reason, a cooperative advertising plan in which dealers received reimbursement from their upstream supplier only if their advertisements used the recommended retail price or no price at all. The court noted that the dealers were free to advertise at any price they chose, at their own expense, and were free to sell at any price. The FTC, in 1987, rescinded an earlier policy statement and adopted a rule of reason analysis for cooperative advertising programs. *Rescission of 1980 Statement of Policy Regarding Price Restrictions in Cooperative Advertising Programs*, 6 Trade Reg. Rep. (CCH) ¶ 39,057 (May 21, 1987). In explaining its new position regarding cooperative advertising programs, the FTC recognized that "[t]he fact that a distributional restraint may have an incidental effect on resale prices is not by itself enough to condemn the practice as *per se* unlawful. . . . [P]rice restrictive cooperative advertising programs are likely to be procompetitive or at least competitively neutral in most cases." *Advertising Checking Bureau, Inc.*, 109 F.T.C. 146, 147 (1987) (order modification). The FTC subsequently modified a series of old consent orders expressly to eliminate provisions that prohibited the conditioning of cooperative advertising allowances on use of the upstream supplier's suggested prices in advertisements. *See Onkyo U.S.A. Corp.*, Docket No. C-3092, 1996 FTC LEXIS 473 (FTC Oct. 24, 1996); *Pendleton Woolen Mills, Inc.*, Docket No. C-2985, 1996 FTC LEXIS 427 (FTC Sept. 30, 1996); *Interco Inc.*, Docket No. C-2929, 1995 FTC LEXIS 68 (FTC March 27, 1995); *Clinique Laboratories, Inc.*, 116 F.T.C. 126 (1993); *U.S. Pioneer Electronic Corp.*, 115 F.T.C. 446 (1992); *The Magnavox Co.*, 113 F.T.C. 255 (1990).

[4] Upstream suppliers have been permitted to advertise suggested resale prices directly to final consumers, even though this practice might have the practical effect of limiting the pricing freedom of dealers as a

competitive allowances[5], wholesale price formulae[6], joint

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result of market forces. Price advertising by upstream suppliers is frequently used in their promotional campaigns, where the promotion of a uniform retail price is a key element of the campaign. Typically, the upstream supplier will disavow any intention to control the actual sales price of its dealers by including a "participating dealer" limitation in advertisements. This practice is therefore akin to a "suggested resale price," which is subject to rule of reason analysis. *See, e.g., Acquaire v. Canada Dry Bottling Co. of N.Y., Inc.*, 24 F.3d 401, 411 (2d Cir. 1994) (provision by manufacturer of suggested wholesale price to retailers was not vertical price fixing, even though retailers would resist paying a higher price to the wholesaler than the suggested wholesale price); *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d at 707 ("it is perfectly lawful for a manufacturer to advertise his product to the ultimate consumer, whether or not he sells directly to the consumer, and to mention in that advertising the retail price of the prod[illegible]").

[5] Many upstream suppliers provide price reductions or rebates to dealers on the condition that the discounts are passed through to consumers. Most lower courts have recognized that upstream suppliers who are lowering their prices have a legitimate interest in making sure that the dealer is not pocketing this "price support" or "competitive allowance" instead of passing it on. Accordingly, as long as dealers are free to determine their resale prices, price support programs repeatedly have been evaluated and upheld under a rule of reason analysis. For example, in *AAA Liquors, Inc. v. Joseph E. Seagram & Sons*, 705 F.2d 1203 (10th Cir. 1982), *cert. denied*, 461 U.S. 919 (1983), the Tenth Circuit upheld a program in which the upstream supplier, Seagram, granted discounts to a wholesaler on the condition that they be passed on to certain retailers. The wholesaler was free to decline the discount and retain complete pricing freedom, or to accept the discount and "pass it through" to retailers. The court concluded that "[a] supplier who grants discounts to a retailer to permit the retailer to charge competitive prices has a legitimate interest in making sure the retailer receiving the discount 'is not pocketing the price support instead of passing it on to consumers.'" *Id.* at 1206 (quoting *Lehrman v. Gulf Oil Corp.*, 464 F.2d 26, 40 (5th Cir.), *cert. denied*, 409 U.S. 1077 (1972)). *See also*

price promotions[7], and price strategies based on external

Acquaire v. Canada Dry Bottling Co. of N.Y., Inc., 24 F.2d at 410-11; *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d at 707-08; *Lewis Serv. Center, Inc. v. Mack Trucks, Inc.*, 714 F.2d 842 (8th Cir. 1983), *cert. denied*, 467 U.S. 1226 (1984).

[6] The lower courts have applied a rule of reason analysis to wholesale pricing formulae (*i.e.*, where the upstream supplier's wholesale price is based on the dealer's resale price) as long as the retailer has been permitted to derive substantial benefit when it deviates from the upstream supplier's suggested resale price. For example, in *Martindell v. News Group Publications*, Inc., 580 F. Supp. 330 (E.D.N.Y. 1984), the court upheld the legality of a price formula in which a newspaper publisher charged its distributors the greater of: (1) a fixed wholesale price if the distributor resold newspapers at no greater than the publisher's suggested resale price; or (2) a percentage of the actual resale price if the distributor resold newspapers for more than the suggested resale price. The court recognized that this formula permitted distributors to derive substantial benefits from their pricing decisions. *See General Cinema Corp. v. Buena Vista Distribution Co.*, 681 F.2d 594 (9th Cir. 1982) (where a movie supplier charged its dealers a fixed percentage of the greater of the suggested resale price or the actual resale price of ticket sales, the court found that this system did not induce dealers to set resale prices at non-competitive levels and therefore did not constitute vertical price fixing).

[7] Upstream suppliers and dealers have a strong interest in jointly developing and promoting their products, including joint promotions relating to prices. The lower courts have recognized the desirability of this activity and, so long as dealers retain pricing discretion, have applied a rule of reason to joint promotional conduct. *See Nissan Antitrust Litigation*, 577 F.2d 910 (5th Cir. 1978), *cert. denied*, 439 U.S. 1072 (1979) (not unreasonable *per se* to anchor advertised prices to upstream supplier's suggested resale price); *United States v. Pittsburgh Area Pontiac Dealers, Inc.*, 1978-2 Trade Cas. (CCH) ¶ 62,233 (W.D. Pa. 1978) (consent decree with dealer association permitting joint

factors.[8] These practices have themselves occasionally been challenged as *per se* unlawful vertical price fixing but, in recognition of the procompetitive benefits offered to consumers by the practices, the lower courts generally have treated them under the rule of reason approach. See notes 3 - 8 *supra*. However, upstream suppliers must devote substantial resources to develop, administer, and enforce these programs.

Direct control over a franchisee/dealer's maximum prices, rather than indirect influence through these various practices, offers the same benefits as the foregoing practices at much lower cost. Moreover, many of these marketing approaches are impracticable or insufficient to benefit

advertising of upstream supplier's suggested retail prices); *cf. Williams v. I.B. Fisher Nevada*, 999 F.2d 445 (9th Cir. 1993) (recognizing that joint activity by franchisor and franchisee cannot provide the basis of a conspiracy because franchisor and franchisee were "common enterprise" and, therefore, were incapable of conspiring with one another).

[8] Upstream suppliers might desire to position their goods and services within a specific market niche or price range at the dealer level. While the specification of prices or price ranges by the upstream supplier might be viewed as vertical price fixing, a requirement that dealers price the goods or services in accordance with certain external factors, that are not within the upstream supplier's control, should be subject to a rule of reason standard. For example, a requirement that dealers price goods or services in relation to the price of a competitor's goods or services (*e.g.*, at a price no greater than the price of competing products) is procompetitive and should not automatically be deemed unlawful. *Cf. Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995) (upstream supplier's policy of basing sales prices to one group of customers upon sales prices to another group of customers "is not price-fixing" and "is the sort of conduct that the antitrust laws seek to encourage"), *cert. denied*, -- U.S. --, 116 S.Ct. 1228 (1996).

consumers, and they are no substitute, in terms of economic efficiency, for maximum vertical price fixing. Maximum vertical price fixing is simply a superior method of bringing lower retail prices to the consumer.

* * * *

Although the case for a rule of reason approach is more evident in franchise and dealership systems than in other vertical relationships, it should be clear that the rule of reason approach is warranted for maximum vertical price fixing in all vertical settings. It is time to recognize that the application of the rule of reason to maximum vertical price fixing will benefit consumers and the efficient functioning of the distribution system.

CONCLUSION

The antitrust laws are a "consumer welfare prescription." *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979). They are designed to "increase economic efficiency and render markets more, rather than less, competitive." *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19-20 (1979). There is now a virtual consensus that the *per se* prohibition on maximum vertical price fixing serves neither of these goals. Accordingly, The Coalition For Fair Consumer Pricing respectfully urges the Court to declare that maximum vertical price fixing arrangements are to be evaluated under the more flexible rule of reason standard.

Respectfully submitted,

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In The Supreme Court of the United States

October Term, 1996

State Oil Company,
Petitioner,
v.
Barkat U. Khan, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF *AMICUS CURIAE* OF THE NATIONAL BEER WHOLESALERS ASSOCIATION, INC. IN SUPPORT OF PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-871

STATE OIL COMPANY,
Petitioner,

v.

BARKAT U. KHAN, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF *AMICUS CURIAE* OF THE NATIONAL BEER WHOLESALERS ASSOCIATION, INC. IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*

The National Beer Wholesalers Association, Inc. ("NBWA") is a nonprofit voluntary business association incorporated under the laws of the Commonwealth of Virginia.[1] The NBWA is a trade association representing the interests of 1,741 beer wholesalers who serve both suppliers and retailers. As the middle tier of a three-tier distribution system mandated in almost every state,[2] beer

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[1] Consent to the filing of this brief, which was obtained from counsel for both parties, has been filed with the Clerk of this Court.

[2] With the exception of micro-breweries and brew-pubs where all three functions—brewing, wholesaling and retailing—are combined, all states except Massachusetts and Wisconsin mandate a three-tier

wholesalers have a special understanding of the competitive consequences of vertical distribution restraints. The proper application of the antitrust laws to pricing arrangements between wholesalers and their suppliers and retailers is central to the effective operation of the free market distribution system. In addition, because every state except Indiana either permits or requires brewers to designate exclusive territories for their wholesalers,[8] NBWA members have a direct interest in this case, especially insofar as it involves an application of the rationale of *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

STATEMENT

This is a classic case whereby a supplier has an interest in the price charged by the dealer because the price otherwise may not be consistent with the competitive plan adopted by the supplier and agreed to by the dealer. The maximum resale price upon which the dealer and supplier agree presents no credible threat of becoming either part of a minimum vertical price agreement or of a horizontal cartel among dealers or suppliers.

Petitioner State Oil Company is a petroleum supplier which sold gasoline to a dealer at a wholesale price determined by subtracting 3.25 cents per gallon from the suggested retail price set by the supplier. Under the terms of the contract, if the dealer sold gasoline at a price higher than the suggested retail price, he was required to rebate the excess to the supplier. Because the dealer's volume would presumably decrease at the higher price (under the laws of supply and demand), and the dealer would not be allowed to keep the increased margin per gallon, the dealer

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system of distribution of beer. Steve L. Barsby & Assocs., Inc., BEER WHOLESALERS: THEIR ROLE AND ECONOMIC PERFORMANCE 13 (2d ed. 1995).

[8] Of these, 29 states mandate exclusive territories. S. Barsby, *supra* note 2, at 6-7.

was effectively foreclosed from charging more than the suggested retail price.

When the supplier terminated the contract to pay the agreed-upon amount, the dealer, Khan, sued, alleging, *inter alia*, price fixing in violation of section 1 of the Sherman Act, 15 U.S.C. § 1. Summary judgment for defendant State Oil Company was granted by the trial court on the alleged price fixing charge because, it said, under the Sherman Act the legality of that conduct was to be "considered under 'rule of reason,' not *'per se,'* analysis," (Pet. App. 35a), and the plaintiff had presented no evidence on the essential elements of a rule of reason case. However, the Seventh Circuit, relying upon *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), reversed because the practical effect of the contractual arrangement was "maximum price fixing" and because "the Supreme Court has thus far refused to reexamine the cases in which it has held that resale price fixing is illegal *per se* regardless of the competitive position of the price fixer or whether the price fixed is a floor or ceiling." Pet. App. 4a & 6a.

SUMMARY OF ARGUMENT

The *per se* rule set forth in *Albrecht* shelters opportunism and forces suppliers and wholesalers to use less efficient distribution alternatives. This rule is plainly inconsistent with the "consumer welfare" and "competition based on efficiency" premises of modern antitrust law articulated by this Court during the past two decades. *Albrecht* (decided in 1968) is an historic relic. Its *Schwinn*-derived premise—that exclusive territories are illegal *per se*—was overturned by this Court in *Sylvania* in 1977.

The flat *Albrecht* prohibition should be replaced by the rule of reason for the reasons articulated in *Sylvania*. Both types of restraints—maximum RPM and vertical nonprice restraints—are adopted to encourage efficient distribution of the supplier's product in a context that may

include exclusive arrangements. Both are adopted to intensify interbrand competition.

Maximum RPM does not eliminate any interbrand price competition; it does eliminate sales-retarding opportunism; and it directly benefits consumers by assuring that price promotions are actually offered to them. Maximum RPM is different in purpose and effect from minimum RPM, and does not present any credible risk of becoming a vehicle supporting a horizontal cartel among suppliers or dealers.

The *Albrecht* rule should be reversed just as other outmoded antitrust doctrines were overturned by this Court in *Sylvania* and *Copperweld*.

ARGUMENT

In *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), this Court repudiated its ten-year old rule of *per se* illegality applied to exclusive territories and other nonprice vertical restraints. In adopting a rule of reason for evaluating such restrictions, *Sylvania* specifically left undisturbed the *per se* rule first applied to vertical minimum price restraints in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), that had been extended to maximum resale price maintenance ("RPM") in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). *See Sylvania*, 433 U.S. at 51 n. 18. In the intervening 20 years, the Court has had several opportunities to review both minimum and maximum vertical price restrictions, and has substantially narrowed their scope,[4] but it has not directly considered whether the *per se* rule applicable to maximum RPM should be continued.

[4] In *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984), and *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), the Court limited the *per se* prohibition of vertical price agreements by establishing more stringent evidentiary requirements. Plaintiffs must now demonstrate that an agreement had been reached (a mere showing of coercion is not enough) and that the agreement set a specific price or price levels. And in *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 339 (1990) ("*ARCO*"), the Court held that a competitor could not suffer antitrust injury as a matter of law where the maximum price was not predatory.

This case directly presents the Court with the question of whether to reconsider *Albrecht*, perhaps the most heavily criticized relic of antitrust's "mothball fleet,"[5] and to apply a consistent test for vertical distribution restrictions designed to ensure effective product promotion and service. We urge the Court to take advantage of this opportunity and to overrule *Albrecht*.

I. THE *ALBRECHT* RULE OF *PER SE* ILLEGALITY IS HARMFUL TO CONSUMER INTERESTS, ERRONEOUSLY INSULATES OPPORTUNISM AND UNDERCUTS THE BENEFITS OF EXCLUSIVE TERRITORIES

Price ceilings on the resale of a product, or their more costly surrogates,[6] are adopted by suppliers and dealers[7] to ensure that a product or service is not overpriced and that the full benefits of exclusive territorial agreements are obtained. Consumers benefit from maximum RPM because it lowers prices and assures greater product availability. Dealers recognize that maximum price limits are necessary adjuncts to grants of protected intrabrand territories and that they serve to prevent free-riding opportunism. Suppliers seek these price agreements with dealers to maximize sales and fully penetrate markets. And pub-

[5] *See* R. Steuer, *Monsanto and the Mothball Fleet of Antitrust*, 30 Antitrust Bull. 1 (1985).

[6] *See* discussion pp. 13-14, *infra*.

[7] Maximum RPM is used in two-tier (supplier-dealer) and three-tier (supplier-distributor-retailer) arrangements. This Brief uses the supplier-dealer terms to describe both except when referring to the beer industry where the terms used are brewer-wholesaler-retailer.

lic welfare is enhanced by maximum RPM because increased output and allocative efficiency result. *See, e.g.*, F. Easterbrook, *Maximum Price Fixing*, 48 U. Chi. L. Rev. 886, 891-900 (1981).

A. Exclusive Territories Are Important Tools for Efficient Distribution Systems Which Benefit Consumers, Suppliers and Dealers

Exclusive territories and related nonprice vertical restraints limiting *intra*brand competition are justified because they strengthen *inter*brand competition. They are adopted to encourage and protect dealer promotion of a product or service through advertising, pre- and post-sale servicing, warranties, market evaluation, and numerous other services. *Sylvania*, 433 U.S. at 54-55.

Beer, for example, is a perishable product. Both draft and bottle must be rotated—between 45 and 60 days for draft beer and between 90 and 150 days for bottle beer [8] —to ensure the beer's fresh taste. Beer wholesalers prevent product deterioration by assisting retailers (subject to the limitations of state law) in product shelving and inventory control and by accepting returns. These services benefit brewers by enhancing the value of their brands. Beer wholesalers also work closely with brewers to identify market trends and to install product displays as well as to advertise and otherwise promote their brands. In return for exclusive territorial rights, beer wholesalers have an obligation to serve all retail outlets in their assigned territory and to provide such services. The result of these bilateral agreements is that the product is widely available and attractive both to retailers and their customers. Because these generally recognized "redeeming virtues" intensify interbrand competition, nonprice vertical restraints have, since 1977, generally been upheld against antitrust challenge. *See Sylvania*, 433 U.S. at 54 (*quoting Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958)).

[8] *See, e.g.*, Miller Brewing Company, GUIDE TO READING COMPETITIVE CODE DATES 20 (rev. July 1994).

B. The Benefits to Consumers From Exclusive Dealer Territories Are Undercut by the Prohibition on Maximum RPM

While competition from dealers of similar products—interbrand competition—generally provides an effective constraint on any misuse by the dealer, the price of differentiated consumer products may not be fully controlled by such competition. *See ARCO*, 495 U.S. at 343 n.13 (maximum resale price fixing "may actually protect consumers against exploitation by the dealer"). For such products, consumers often will not have freely substitutable choices if the dealer raises the price. For example, in *Albrecht*, the St. Louis newspaper reader of the morning Globe-Democrat had no alternative delivered source for the Globe-Democrat—or, indeed, any other morning newspaper—and the newspaper delivery carrier who had an exclusive territory could (and did) raise the price of the newspaper above the advertised price. *Albrecht*, 390 U.S. at 147. Thus, after *Albrecht*, the consumer could be forced to pay more for the newspaper, and to the extent that newspaper subscribers were price sensitive, readership and advertising revenues would decline. In contrast, maximum RPM protects consumers from higher prices by imposing a ceiling that cannot be exceeded. *See ARCO*, 495 U.S. at 340 ("Low prices benefit consumers regardless of how those prices are set . . . .").

C. Maximum RPM Constrains Opportunism and Free Riding

Exclusive territory or customer arrangements prevent dealers from selling the same product outside their assigned sales territory and from thereby free riding on the service and promotional investments made by authorized dealers in that territory. *See Sylvania*, 433 U.S. at 55. In this context, the free-riding dealer has lower costs because

he does not pay for these promotions and consequently he can cut the price of the product below that charged by the servicing dealer. Without territorial protection, dealers will not invest in services such as total market coverage, product returns, cooperative advertising, etc.

For differentiated consumer products, nonprice vertical agreements unconstrained by maximum RPM create an opportunity for similar free-riding opportunism. That is, a dealer benefiting from a supplier's brand and product, protected from intrabrand competition by non-price restraints such as exclusive territories, may increase the retail prices of the product or service above the usual (competitive) mark-up. In doing so, the dealer benefits from the brand name and its reputation for quality but, as in *Albrecht*, denies the supplier part of the benefit of that brand by increasing price and reducing sales.[9] In the instant case, the dealer was not selling its own distinctive gasoline, but "Union 76" gasoline, a brand product with a separate identity and customer loyalty developed in part by competitive prices and services. *Cf. Simpson v. Union Oil Co.*, 377 U.S. 13 (1964).

The same is true of the beer market where brewers advertise their brands nationally to create a strong product identification and following. Such national promotions often include specials with substantial price breaks. Beer wholesalers participate because the brewer funds a portion of the price reduction and because it is in their interest to maintain demand. But an occasional beer wholesaler may take a short-run view and decline to participate in the promotional price. In doing so, that nonparticipating wholesaler injures the other wholesalers as well as

[9] The Court in *Albrecht* particularly erred in failing to take account of the newspaper's legitimate interest in protecting its circulation base against the opportunism of newspaper carriers. Circulation is critical to publishers because it determines advertising rates which are the largest source of newspaper revenues. *See* H. Hovenkamp, *Vertical Integration by the Newspaper Monopolist*, 69 Iowa L. Rev. 451, 455-56 (1984).

their brewer; that wholesaler is free riding on the national promotion subsidized in part by other wholesalers. The long-run effects of such opportunism are to reduce product promotions, reduce demand for that brand, and create disruptive consumer confusion.

D. Maximum RPM Allows Suppliers to Choose the Most Efficient Distribution System for Their Product or Service

In other words, exclusive territories joined with maximum RPM are often the most efficient degree of vertical integration. The *Albrecht* rule denies suppliers and dealers this choice. By forcing use of alternative distribution systems, the rule increases distributional costs which are passed on to consumers in competitive markets. In addition, such legal constraints unnaturally discourage independent business enterprises. Beer wholesalers, for example, are small businesses which add $52 billion of value annually to the economy and have an average of 32 employees.[10] Where the rule against maximum RPM can be avoided by other mechanisms (e.g., rebates, profit-passovers, minimum inventory levels and purchase requirements),[11] many of the same benefits can be achieved. But reliance on such semi-covert techniques is less efficient, includes additional problems, and is at most a second best solution.

[10] *See* Steve L. Barsby & Assocs., Inc., ECONOMIC CONTRIBUTIONS OF THE BEER INDUSTRY, 1995 (1996). The three-tier system of distribution of beer mandated in almost every state, *see* note 2, *supra*, was adopted under the 21st Amendment for public policy reasons to ensure greater state control over the sale and consumption of alcoholic beverages and to maintain an effective system of taxation of such products. *See North Dakota v. United States*, 495 U.S. 423, 426 & 428 (1990). That system is also highly effective for the distribution of perishable products. And a rule permitting maximum RPM justified on efficiency grounds is fully consistent with this state-mandated regulatory regime.

[11] *See* pp. 13-14, *infra*.

II. *ALBRECHT* IS BASED ON THE OVERRULED HOLDING IN *SCHWINN* AND IS WHOLLY INCONSISTENT WITH THE RULING IN *SYLVANIA*

Decided a year after *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), *Albrecht's* condemnation of maximum RPM is grounded in *Schwinn's per se* prohibition of vertical restraints and its assumption that exclusive territorial agreements are undesirable and anticompetitive. *See Albrecht*, 390 U.S. at 154. *Schwinn*, however, was expressly overturned by this Court's decision in *Sylvania*, 433 U.S. at 57. Thus, *Albrecht's* basic premise, that exclusive territorial agreements are rare and dealer opportunism unlikely, is no longer valid.

A. *Albrecht* Is the Stepchild of the Discredited *Schwinn* Doctrine

In holding that maximum vertical price fixing was *per se* illegal, the Court, in *Albrecht*, specifically rejected the reasoning of the lower court that "a price ceiling was necessary to protect the public from price gouging by dealers" who had exclusive rights in their own territories. 390 U.S. at 153. It explained that the court below had assumed, erroneously, "that the exclusive rights granted by [Schwinn] were valid under § 1 of the Sherman Act." *Id.* at 153-54 (*citing Schwinn*, 388 U.S. at 373 & 379). The *Albrecht* Court therefore concluded:

> The assertion that illegal price fixing is justified because it blunts the pernicious consequences of another distribution practice is unpersuasive. If, as the Court of Appeals said, the economic impact of territorial exclusivity was such that the public could be protected only by otherwise illegal price fixing itself injurious to the public, the entire scheme must fall under § 1 of the Sherman Act.

Id. at 154.

However, as the Court has recognized, the conclusion in *Albrecht* no longer follows once the premise of *Schwinn*

was overturned. *See ARCO*, 495 U.S. at 343 n.13 ("The procompetitive potential of a vertical maximum price restraint is more evident now than it was when *Albrecht* was decided, because exclusive territorial arrangements and other nonprice restrictions were unlawful *per se* in 1968."). *Albrecht* assumed, in light of the *Schwinn* prohibition, that few if any dealers would be freed of intrabrand competition or in a position to misuse that power contrary to the interests of the supplier, other dealers or consumers. It relied principally on the *per se* prohibition of exclusive territories to justify the same rule for maximum RPM. In contrast, *Sylvania* centered on the premise that "[v]ertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products." 433 U.S. at 54. These "redeeming virtues" justify "sustaining vertical restrictions under the rule of reason." *Id.*

B. *Albrecht* Cannot Be Reconciled With the Rule of Reason Standard Applied to Nonprice Restraints in *Sylvania*

Albrecht relied on three justifications to condemn maximum RPM: (1) vertical price agreements "'cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment'" (390 U.S. at 152, *quoting Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211, 213 (1951)); (2) such restraints endanger competition "by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market" and thereby impede "the ability of buyers to compete and survive in the market" (*id.*); and (3) "the [maximum RPM] scheme tends to acquire all the attributes of an arrangement fixing minimum prices" (*id.* at 153). *See also Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 348 (1982).

Each of these rationalizations is rejected expressly or impliedly in *Sylvania*.[12] It upholds nonprice agreements that constrain a dealer's choices on where he can sell or must promote the supplier's product, that allow the supplier to select dealer territories, and that eliminate all intrabrand competition. Maximum RPM satisfies the *Sylvania* criteria because such agreements are designed to "increase economic efficiency and render markets more, rather than less, competitive." *United States v. United States Gypsum Co.*, 438 U.S. 422, 441 n.16 (1978). The prohibition on maximum RPM also is counterproductive. It has the perverse effect of encouraging forward vertical integration as, for example, newspaper publishers have shifted to self-distribution.[13] *See Sylvania*, 433 U.S. at 57 n.26 ("To the extent that a *per se* rule prevents a firm from using the franchise system to achieve efficiencies that it perceives as important to its successful operation, the rule creates an incentive for vertical integration into the distribution system . . . ."); *Business Electronics*, 485 U.S. at 725 (recognizing that harsh treatment of vertical restraints "create[s] a perverse incentive for manufacturers to integrate vertically into distribution"). And, as in *Sylvania*, the "great weight of scholarly opinion has been critical" (433 U.S. at 47-48) of *Albrecht*.[14]

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[12] The Court did not directly address the issue of disguised price minima in *Sylvania*, although it did reject the likelihood that exclusive territories would lead to horizontal price cartels. 433 U.S. at 51 n18. *See also* P. Areeda, VIII ANTITRUST LAW ¶ 1637 at 406 (1989) ("there is little or no reason to fear that a vertical maximum might be an undetected minimum").

[13] *See also Paschall v. Kansas City Star Co.*, 727 F.2d 692 (8th Cir.) (*en banc*), *cert. denied*, 469 U.S. 872 (1984) (replacement of independent carriers by delivery agents who are employees of the newspaper); H. Hovenkamp, *supra* note 9, at 460 ("by switching to self-distribution, the *Kansas City Star* hoped to eliminate monopoly pricing by its carriers while avoiding the consequences of *Albrecht*").

[14] Economists: *see* F. Scherer & D. Ross, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 558 (3d ed. 1990) ("Quite

III. THE ILLOGIC AND INCONSISTENCY OF *ALBRECHT'S* CONDEMNATION OF MAXIMUM RPM HARMS COMPETITION AND CAUSES PARTIES TO RELY ON LESS EFFICIENT VERTICAL RESTRAINTS

Continued adherence to the standard of *per se* illegality for maximum RPM while similar more restrictive exclusive territory agreements are tested under a rule of reason is not merely a harmless anomaly of antitrust asymmetry. Few decisions "have proved more anticompetitive" than *Albrecht*. H. Hovenkamp, FEDERAL ANTITRUST POLICY 422 (2d ed. 1994). Few have interfered so directly with higher output, lower prices or supplier profits. Worse yet, the "luminous inconsistency"[15] between *Albrecht* and *Sylvania* causes parties to invent circuitous (and more expensive) alternatives with resulting litigation burdens as each is tested to learn whether another exception to *Albrecht* will find judicial approval. *See Sylvania*, 433 at 48-49 & n.14 ("the experience of the past 10 years should be brought to bear on this subject"). While courts, including this Court, have sought to limit the harm caused by *Albrecht* by applying it narrowly,[16] by approving alternatives[17] or by finding that conduct cannot be chal-

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clearly, [maximum RPM] should not be illegal per se."); R. Blair & A. Esquibel, *Maximum Resale Price Restraints in Franchising*, 65 Antitrust LJ. 157, 160 n.16 (1996) (collecting studies). Legal scholars: *see* P. Areeda, *supra* note 12, ¶ 1638b at 419 ("[V]ertical price ceilings should not be condemned per se. Instead, they should be permitted unless the plaintiff proves them unreasonable in the particular case."); R. Bork, THE ANTITRUST PARADOX 435-36 (rev. ed. 1993) (criticizing the "illogical distinction" applied to vertical price restraints); S. Ross, PRINCIPLES OF ANTITRUST LAW 255 (1993) ("*Albrecht* seems wrongly decided").

[15] R. Bork, *supra* note 14, at 285.

[16] *See* note 4, *supra*.

[17] *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698, 706 (7th Cir.), *cert. denied*, 469 U.S. 1018 (1984) (presumption that action in supplier's self-interest is unilateral).

lenged by a particular plaintiff,[18] the social welfare costs of these covert reversals are substantial. *Cf.* R. Posner, ANTITRUST LAW, AN ECONOMIC PERSPECTIVE 10-11 (1976).

Parties seeking the same ends are forced to adopt less efficient substitutes for RPM. These include: integration of manufacturing and distribution in one firm;[19] dual distribution arrangements;[20] national contracts;[21] sales quotas and related performance standards;[22] and price announcements and rebates.[23] The price clause in the lease agreement in the instant case is illustrative. The parties to the agreement apparently assumed that a lease would be interpreted as a rental agreement despite its supply and price terms, that it did not constitute an agreement to resell gasoline, and that it did not meet the "specific price or price levels" standard. They guessed wrong up to now.

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[18] *ARCO*, 495 U.S. at 339 (nonpredatory price cut imposed on competing dealer through maximum RPM not challengeable where plaintiff could not show antitrust injury); *Jack Walters*, 737 F.2d at 709.

[19] *See Slowiak v. Land O'Lakes, Inc.*, 987 F.2d 1293 (7th Cir. 1993) (termination of dealer).

[20] *See Jack Walters*, 737 F.2d at 706 (threat of direct sales to public if advertised prices not followed).

[21] *See Wisconsin Music Network, Inc. v. Muzak Ltd. Partnership*, 5 F.3d 218 (7th Cir. 1993) (price restraints in national franchise contract judged under rule of reason).

[22] *See* A. Shephard, *Contractual Form, Retail Price, and Asset Characteristics in Gasoline Retailing*, 24 Rand J. Econ. 58, 62 (1993) (gasoline franchise contracts usually specify minimum volumes of gasoline to be purchased).

[23] *See, e.g., Acquaire v. Canada Dry Bottling Co. of N.Y., Inc.*, 24 F.3d 401 (2d Cir. 1994) (verification that promotional discount received by retailer); *AAA Liquors, Inc. v. Joseph E. Seagram & Sons, Inc.*, 705 F.2d 1203 (10th Cir. 1982), *cert. denied*, 461 U.S. 919 (1983).

IV. THIS IS AN APPROPRIATE OCCASION TO OVERRULE THE OUTMODED *PER SE* PROHIBITION OF MAXIMUM RPM

The *per se* rule against maximum RPM is a relic of another era in antitrust and should be expressly overruled. It is inconsistent with the rule of reason applied to parallel nonprice vertical restraints. Its rationale and doctrinal support have evaporated in the last 30 years. And its overruling would not disrupt any industry built upon its base. Thus, as this Court held in *Sylvania* and *Copperweld*, when similar antique antitrust doctrines were expressly repudiated by the Court to bring antitrust law into line with modern economic and legal analysis, the rule of *Albrecht* should be relegated to history. *See Schwinn*, 388 U.S. at 391 (Stewart, J., dissenting: "it is hardly the practice of this Court to embrace a rule of law merely on grounds of its antiquity").

A. *Albrecht's Per Se* Rule, Like Those in *Schwinn* and *Kiefer-Stewart*, Has Caused Suppliers and Dealers to Adopt Less Efficient Business Methods, Has Generated Complex Legal Distinctions, and Has Created Unnecessary Confusion

While it is important that the law be settled, it is even more important that basic rules which have a substantial impact on important and recurring business relationships be decided correctly. Thus, in *Sylvania* this Court held that a perverse *per se* prohibition of nonprice vertical restraints should no longer continue. It was too important a commercial subject to be governed by a counterproductive rule; the *per se* prohibition was based on an erroneous extension of a rule first applied to horizontal restraints; it had generated extensive litigation as businesses sought similar efficiencies by other means; its "barren formalism" was an analytical embarrassment; and its overturning was likely to lead to greater efficiencies by controlling free riding and similar practices contrary to effective distribution. 433 U.S. at 48-54. Each of these reasons, relied

upon in *Sylvania* to overturn *Schwinn*, applies with equal force to justify reversal of *Albrecht* here.

Similarly, in *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 777 (1984), this Court expressly "disapproved and overruled" the malign intra-enterprise conspiracy doctrine of *United States v. Yellow Cab Co.*, 332 U.S. 218 (1947), and *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951). Again, this doctrine had "long been criticized" because the rule looked to "the form of an enterprise's structure and ignore[d] the reality" and because it interfered with efficient organizational forms and encouraged covert subsidiaries. *Id.* at 766 n.12, 772 & 773. The Court pointedly noted that "it ha[d] never explored or analyzed in detail the justifications for [the intra-enterprise conspiracy doctrine]" (467 U.S. at 766) and on doing so, it found that the rule had irrationally "obliterate[d] the [Sherman] Act's distinction between unilateral and concerted conduct" (*id.* at 776). As a consequence, the Court reversed itself and adopted a new rule recognizing the parent-subsidiary corporate relationship as one economic entity despite the fact that the Court had adopted a contrary rule 37 years earlier (and followed or repeated the holding in subsequent cases). The same reasons—of an ancient rule relying on form not substance and of an inefficient rule encouraging covert forms to overcome its strictures—apply to the *Albrecht* rule here.

B. Contrary to the Situation in *Toolson* and *Flood*, Reversal of *Albrecht* Would Not Interfere With an Industry's Reasonable Expectations or Eliminate a Rule That Had Been Implicitly Approved by Congress

This Court has twice refused to overturn the aberrational and anomalous rule in *Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs*, 259 U.S. 200, 209 (1922)—that baseball is not so involved in interstate commerce as to be covered

by the antitrust laws—because "the [baseball] business . . . [was] left for thirty years to develop, on the understanding that it was not subject to existing antitrust legislation." *Toolson v. New York Yankees, Inc.*, 346 U.S. 356, 357 (1953) (*per curiam*). *Accord Flood v. Kuhn*, 407 U.S. 258 (1972). The Court was unwilling to overturn *Federal Baseball* judicially when Congress, by its "positive inaction," allowed those decisions to stand and "ha[d] clearly evinced a desire not to disapprove them legislatively." *Flood*, 407 U.S. at 283-84.

Albrecht cannot be defended on these grounds. The ban on maximum RPM is not an exemption from antitrust coverage; no industry has been built on its rule; and none will be disrupted by correcting its harshness and illogic. Just the opposite. *Albrecht* interferes with the operation of efficient distributional systems for goods and services and permits the kinds of opportunism that this Court was concerned about in *Sylvania*, *Monsanto* and *Business Electronics*. Expunging it from antitrust will free suppliers and dealers to lower costs and improve efficiency. And no confusion or retroactivity problems would result from discarding this inconsistency in the treatment of restraints ancillary to exclusive territories.

Finally, Congress has not considered legislation on *maximum* vertical price fixing nor is there any evidence that Congress supports continuation of the rule in *Albrecht*. In creating the "fair trade" exemption from the Sherman Act in the Miller-Tydings Act, 50 Stat. 693 (1937), and the McGuire Act, 66 Stat. 631 (1952), Congress was protecting *minimum* vertical price fixing. When it repealed those exemptions in the Consumer Goods Pricing Act, Pub. L. No. 94-145, 89 Stat. 801 (1975) (amending 15 U.S.C. §§ 1, 45(a)), Congress was acting on a concern that the exemptions had raised consumer prices. *See* S. Rep. No. 466, 94th Cong., 1st Sess., 3 (1975), *reprinted in* 1975 U.S. Code Cong. & Admin. News 1569, 1570 ("[r]epeal of the Fair Trade laws should result in a lowering of consumer prices"). Similarly, more recent failed efforts

to codify the rule of *Dr. Miles*, 220 U.S. 373, have specifically excepted from *per se* condemnation agreements to set, change or maintain maximum resale prices. S. Rep. No. 42, 102d Cong., 1st Sess., 17-18 (1991) ("although [S. 429 would codify] the *per se* rule for minimum price-fixing, it contains a specific exception for agreements to set, change, or maintain maximum resale prices").

CONCLUSION

The Court should expressly overrule the *per se* standard of *Albrecht* and hold that maximum vertical price agreements henceforth are tested by the rule of reason standard set forth in *Sylvania*.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

—v.—

BARKAT U. KHAN and KHAN & ASSOCIATES,
an Illinois Corporation,

Respondents.

ON CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF OF AMICI CURIAE NEWSPAPER ASSOCIATION OF AMERICA, A.H. BELO CORPORATION, ADVANCE PUBLICATIONS, INC., COX ENTERPRISES, INC., DOW JONES & COMPANY, INC., GANNETT CO., INC., KNIGHT-RIDDER, INC., THE NEW YORK TIMES COMPANY, AND WASHINGTON POST COMPANY IN SUPPORT OF PETITIONER

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Pursuant to Rule 37 (3)(a) of the Rules of this Court, this brief is respectfully submitted in support of Petitioner by Amici Curiae, Newspaper Association of America, A.H. Belo Corporation, Advance Publications, Inc., Cox Enterprises, Inc., Dow Jones & Company, Inc., Gannett Co., Inc., Knight-Ridder, Inc., The New York Times Company and Washington Post Company. The consent of the parties to the filing of this Brief has been received, and has been submitted to the Court.

INTEREST OF AMICI CURIAE

Newspaper Association of America is a nonprofit trade association representing the interests of more than 1500 member newspapers in the United States and Canada. A.H. Belo Corporation, Advance Publications, Inc., Cox Enterprises, Inc., Dow Jones & Company, Inc., Gannett Co., Inc., Knight-Ridder, Inc., The New York Times Company and Washington Post Company all publish newspapers, directly or through subsidiaries or partnerships.

It is estimated that about 60 million newspapers are sold each day in the United States, of which about a third are accounted for by the listed publishers.

A question on which this Court granted certiorari—whether supplier-dealer agreements limiting dealer markups are *per se* violations of the Sherman Act—is of importance to the relationship between suppliers and their wholesale and retail distributors and dealers. It is of particular importance to the newspaper industry. Indeed the Court's leading decision on the subject, *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968) ("*Albrecht*"), involves the relationship between a newspaper and its delivery carriers.

Almost thirty years of experience since the *Albrecht* decision argues against a rule of *per se* illegality for agreements between newspapers and their distributors on maximum prices to their customers. Instead it would be more consistent with the purposes of the antitrust laws for the question of legality

to be determined under the Rule of Reason in light of industry facts and market realities.

The experience of the newspaper industry—with its particular economics—may be helpful to the Court in considering this question.

SUMMARY OF ARGUMENT

Efficient, low-cost distribution is important to newspapers.

Newspapers may suffer losses in circulation and eventually advertising revenue if their distributors—wholesalers, home delivery carriers or other outlets—charge excessive prices. If distributors could lawfully agree not to do so, newspapers as well as readers would benefit. But, because vertical maximum price agreements are understood to be forbidden by *Albrecht*, many newspapers have guarded against excessive pricing by integrating forward into distribution themselves. Where such integration does not result in greater efficiency, it increases newspapers' costs without enhancing competition.

Albrecht's rule of *per se* illegality for vertical maximum price agreements between newspapers and their distributors is inconsistent with later authority that *per se* illegality is reserved for conduct that would "always or almost always" tend to restrict competition and decrease output. Vertical maximum price agreements are not likely to affect competition materially. If they have any effect on output it would be to *increase* output.

A rule of *per se* illegality for such agreements is particularly inconsistent with the approach now taken by this Court to ascertain competitive effects in other cases involving intrabrand and interbrand competition.

Finally, *Albrecht* makes legality depend on a single factor, whereas the true competitive impact of vertical maximum price agreements in the newspaper industry should be determined in light of the totality of market realities.

ARGUMENT

1. *Albrecht's* Per Se Rule Can Impose Unnecessary Costs

Newspapers derive revenue from two sources: readers and advertisers. For the great majority of newspapers revenue derived from readers accounts for less than half of the newspaper's revenues. Some estimates are in the range of 20% to 30%. *Facts about Newspapers 1996* (Newspaper Association of America); Compaine, *The Newspaper Industry in the 1980s: An Assessment of Economics and Technology* (1980). Most remaining revenue is derived from advertisers. Advertising revenue, however, hinges on circulation. Advertisers often make their placement decisions on the basis of cost per thousand readers. Audited circulation data is made available to them. Maintaining and increasing circulation is therefore vital to newspaper prosperity.

For the advertisers who are their primary source of revenue, newspapers face competition from a number of sources. In addition to other newspapers, competitors include direct mail advertising services, other delivery services for printed material, television broadcasters and cablecasters, radio, magazines, other publications, and more recently, on-line electronic information services. This type of horizontal competition is "interbrand" as that term is used in the Court's decision in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) ("*GTE Sylvania*"). For sales of particular newspapers some competition may take place within the distribution channels for that newspaper. Such competition, which is usually not as great as the competition for advertisers, is "intrabrand" within the meaning of *GTE Sylvania*.

Newspaper distributors are commonly given different areas of primary responsibility. Without such assignments distributors could be expected to concentrate their efforts on easier-to-serve areas with high reader density and ignore less heavily populated areas with relatively fewer readers. To remain competitive, a newspaper also wants to encourage coverage of all targeted areas at lowest cost. This may cause the newspaper to stipulate that a designated area will be served by a single distributor. Where designations do not confine dealers to particular areas, distributors may nonetheless, because of cost considerations, confine their operations primarily to the areas for which they are responsible.

If only a single distributor serves a particular area, competition with other distributors of the newspaper will not limit the amount that distributor charges customers. Intrabrand competition, by definition, does not exist in those circumstances. Unless restrained by the newspaper, therefore, or by interbrand competition, such a distributor may set its charge at a level which although acceptable to some readers is also excessive for some of them. Or to put it another way, a profit-maximizing distributor will increase price (thus reducing output) until it finds the greatest differential between its revenue and costs. In reducing output, it will be acting contrary to the long-run interest of the newspaper, which is typically to reach the greatest number of readers that can be efficiently served.

Such conflicts of interest arise particularly in the newspaper industry because a newspaper's stream of revenue from advertisers depends in large part on the success of its circulation efforts. Similar conflicts may conceivably exist between the interests of suppliers and dealers in other industries. This is a question of fact which should depend, inter alia, on whether suppliers and dealers find it most advantageous to operate at different levels of output.

A straightforward and efficient way of resolving this conflict in the newspaper–distributor context would be for the

parties to negotiate and reach agreement on the maximum charge to be made by the distributor, leaving the distributor room to charge less (and presumably make more sales) if it can profitably do so. As generally understood, however, *Albrecht* prohibits such agreements. Accordingly, some newspapers have accepted the risk of losing both subscribers and advertiser revenue because of distributor pricing. Other newspapers have adopted some form of vertical integration.

For example, a newspaper may cease dealings with independent distributors and provide all distribution service with its own employees and vehicles. Or the newspaper may continue dealings with independent distributors but may change the nature of these dealings. Instead of selling to distributors for resale, the newspaper may contract with distributors for delivery service only, or appoint them as delivery agents. The newspaper then assumes some or all of the functions of billing newsstands and subscribers, making collections, and maintaining customer lists. These arrangements allow the newspaper to control pricing to newsstands and home delivery subscribers, but at the cost of additional capital investment. In some cases efficiency may be improved; in other cases it may suffer. There is a probable loss of efficiency where, as in *Albrecht*, the newspaper would rather not be in the delivery business. 390 U.S. at 147. These arrangements have also found resistance from distributors. Integration in the newspaper industry has given rise to extensive litigation, which is summarized in Areeda & Hovenkamp, *Antitrust Law* (1996 Supplement) § 729.7.

It is respectfully submitted that unless vertical integration enhances efficiency, its consequences may not be salutary. Integration can impose additional costs on publishers, reduce entrepreneurship opportunities for distributors, and perhaps ultimately injure newsstands and subscribers by withholding the more affordable delivery service the market could otherwise provide. These consequences are not needed to preserve competition.

2. *Albrecht's* Per Se Rule Is Inconsistent with Later Precedent.

It has been a consistent theme of this Court's recent antitrust rulings that *per se* treatment is reserved for conduct that would "always or almost always tend to restrict competition and decrease output". *Broadcast Music, Inc.* v. *Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19-20, (1979). *See also National Collegiate Athletic Ass'n* v. *Board of Regents of University of Oklahoma*, 468 U.S. 85, 100 (1984) (". . . a *per se* rule is applied 'when the practice facility appears to be one that would always or almost always tend to restrict competition and decrease output' ") (citing *Broadcast Music*); *FTC* v. *Indiana Federation of Dentists*, 476 U.S. 447, 458-59 (1986) ("we have been slow to . . . extend *per se* analysis to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious") (citing *Broadcast Music*); *National Society of Professional Engineers* v. *United States*, 435 U.S. 679, 692 (1978):

> "There are, thus, two complementary categories of antitrust analysis. In the first category are agreements whose nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality—they are 'illegal *per se*.' In the second category are agreements whose competitive effects can only be evaluated by analyzing the facts peculiar to the business, the history of the restraint, and the reasons why it was imposed. In either event, the purpose of the analysis is to form a judgment about the competitive significance of the restraint. . . ."

It is therefore pertinent to consider whether a vertical agreement setting maximum prices in the circumstances described above injures competition or limits output. The answer is plain:

Single-distributor areas. In areas served by only a single newspaper distributor, a vertical agreement limiting maximum resale prices would not limit output; on the contrary, whenever a marginal subscriber renews rather than cancels, service is rendered that would otherwise be withheld. In other words, a maximum charge tends to *expand* rather than decrease output.

It is also apparent that a vertical maximum price agreement in these circumstances would not injure competition. The only competition arguably affected is intrabrand competition with other distributors of the newspaper. Where for reasons of efficiency only one distributor chooses or is designated to serve a particular area, there is rarely any significant intrabrand competition to be injured. The practical effect of a vertical maximum price agreement in a single distributor area is thus not to limit competition significantly but rather to limit exploitation of the degree of market power, however minimal, conferred by the grant of exclusivity.

Multiple-distributor areas. In those circumstances where two or more distributors may vie for circulation sales, it is equally true that newspaper-distributor agreements placing ceilings on distributor prices would tend to expand rather than limit output, if they had any effect at all.

There is also ground for concluding that competition would not be harmed in these circumstances. First, it is doubtful that the maximum price will reduce the extent of intrabrand competition. The maximum price would not prevent distributors from competing on price or service. Each could still charge as little as it wished. It is highly unlikely that the maximum price would prevent innovation or improving quality of service. Each distributor will have the incentive to increase sales and become as efficient as possible, as well as having an obligation to the newspaper to maintain standards of service to earn customer satisfaction. A newspaper would have no

incentive to place the maximum so low as to jeopardize customer satisfaction.

Second, to determine anticompetitive consequences, any potential anticompetitive effect on intrabrand competition should be weighed against the effect on *inter*brand competition. If *GTE Sylvania*'s paradigm is applied, any discernible loss to intrabrand competition brought about by the restriction would be outweighed by the obvious gain in interbrand competition. There can be no question that it is significantly procompetitive for a newspaper to try to keep its cost to customers down so as to avoid loss of business to competitors such as direct mail. The significant procompetitive interbrand effect should overwhelm any potentially anticompetitive intrabrand effect, particularly a remote one. Interbrand competition, after all, is "the primary concern of antitrust law." *GTE Sylvania*, 433 U.S. at 52. This competition has become far more serious for the newspaper industry in the nearly thirty years since the *Albrecht* decision.

3. *Albrecht's* Per Se Rule Is Particularly Inconsistent With the Principle, Expressed in *Sharp*, Favoring Analysis Under the Rule of Reason.

In 1988 this Court reviewed the interface between the rule of *per se* illegality for resale price maintenance agreements and the principle of Rule of Reason review for other vertical arrangements. *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717 (1988). The Court did so in a case involving termination of a dealer for price-cutting. The Court's rationale applies to the current issue and warrants application of the Rule of Reason.

In *Sharp* the Court pointed out that all vertical restraints have some potential to affect prices, so that giving *per se* treatment to all vertical arrangements affecting pricing would in effect destroy the normal principle of evaluating vertical restraints under the Rule of Reason. The *per se* exception

would then swallow the Rule of Reason. *Sharp* therefore held that for *per se* liability to attach to a restraint, even one affecting pricing, the restraint must do more than merely affect pricing. It must constitute agreement on a resale price, or if not a specific price, a resale price level.

By the same token, a vertical agreement setting maximum resale prices may affect pricing but is not an agreement on specific resale prices or actual price levels. As in *Sharp*, such conduct does not eliminate the dealer's ability to determine its prices but rather leaves open the possibility of lower-than-maximum pricing by the dealer.

Moreover, a vertical maximum price agreement does not pose the same threat to competition as a vertical price agreement setting specific prices or formulas for determining price. Unlike the latter, vertical *maximum* price agreements cannot assist horizontal price-fixing at the manufacturer level, since they leave distributors free to charge lower prices to consumers, and lower prices may well be in the distributor's interest where the distributor is efficient.

Also, in concluding that *per se* illegality could not be shown without agreement on price or price levels, the Court in *Sharp* noted specifically that there was a presumption in favor of a Rule of Reason standard, that departure from that standard must be justified by demonstrable economic effects, such as the facilitation of cartelizing, rather than formalistic distinctions, that interbrand competition is the primary concern of the antitrust laws and that rules in this area should be formulated with a view toward protecting the doctrine of *GTE Sylvania*. *Sharp*, 485 U.S. at 726.

All of these factors argue for testing vertical maximum price clauses under the Rule of Reason formulated in *GTE Sylvania*, which best serves the interests of interbrand competition and consumer welfare.

4. *Albrecht's* Per Se Rule Gives Excessive Weight to a Single Factor.

The basic rationale of *Albrecht* was that an agreement to fix maximum prices could jeopardize the ability of a dealer to furnish essential services to customers and thus also jeopardize the survival of a dealer:

> ". . . schemes to fix maximum prices by substituting the perhaps erroneous judgment of a seller for the forces of a competitive market, may severely intrude upon the ability of buyers to compete and survive in that market . . . . Maximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which consumers desire and for which they are willing to pay." *Albrecht*, 390 U.S. at 152-53.

It is undoubtedly true that while it would seldom serve a supplier's interest to jeopardize the survival of its dealers by fixing maximum prices too low, a supplier could conceivably do so. It could also unwittingly prejudice its dealers in other ways, such as by charging so much for its products that dealers are unable to resell them profitably, or by opening additional outlets too close to an existing dealer. However, these hazards to dealers are not necessarily hazards to competition. In some circumstances each may form part of the context of an untenable restraint on competition, but in others each may result in providing competitive opportunities for third parties. Opening a more efficient dealer, for example, may be hazardous to existing dealers but desirable for better competition. To make hazards to particular dealers determinative of the outcome is to ignore other market realities and risk the very harm to competition which the Sherman Act seeks to avoid.

More specifically, the quoted passage from *Albrecht* invites the assumption that the seller may establish too low a maximum for some dealers to survive. Should courts not consider the alternative possibility that some dealers may set prices

which are too high? Newspapers' revenue comes mainly from large advertisers who choose among alternative means of delivering advertising messages—by newspapers, direct mail and other means—partly on the basis of audience reached. A newspaper's loss of audience because of high delivery charges can lead to a loss of key advertisers. This in turn can reduce the funds available for editorial quality and cause a further loss of audience, with consequent impact on all distributors, including those who have kept prices down. Thus the erroneous judgment of some distributors, seeking to enhance their own short-run profits, can bring about longer-term losses to themselves, newspapers and other distributors.

If on the other hand a newspaper is free to reach agreements with distributors on maximum prices in appropriate circumstances, the likelihood is greater that the maximums will be low enough to keep circulation at a level that will be attractive to advertisers, while still allowing distributors to profitably serve areas which are particularly costly to reach.

In short, the *Albrecht per se* rule attaches too much importance to the possibility that maximum prices will be set too low. In assessing overall competitive impact other factors are more important. For example: What are the reasons for the practice? What effects have resulted? How effective is interbrand competition in the particular case? How effective is intrabrand competition? Does the seller have market power? Does the dealer have market power? Does the dealer act on behalf of competitors of the seller? What are the relevant entry barriers? What has been the pattern of entry and exit? The answers in a particular case may support a finding that the arrangement is on balance procompetitive.

In 1990, this Court recognized that vertical maximum price-fixing may have procompetitive effects. *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 495 U.S. 328, 343 n.13 (1990). It is respectfully suggested that in light of the Court's analysis of such possible benefits, a *per se* rule is inappropriate. As this Court observed in *Atlantic Richfield*:

"[13]When a manufacturer provides a dealer an exclusive area within which to distribute a product, the manufacturer's decision to fix a maximum resale price may actually protect consumers against exploitation by the dealer acting as a local monopolist. The manufacturer acts not out of altruism, of course, but out of a desire to increase its own sales—whereas the dealer's incentive, like that of any monopolist, is to reduce output and increase price. If an exclusive dealership is the most efficient means of distribution, the public is not served by forcing the manufacturer to abandon this method and resort to self-distribution or competing distributors. Vertical, maximum price fixing thus may have procompetitive interbrand effects even if it is *per se* illegal because of its potential effects on dealers and consumers. See *Albrecht* v. *Herald Co.*, 390 U.S. 145, 159 (1968) (Harlan, J., dissenting) (maximum price ceilings 'do not lessen horizontal competition' but instead 'drive prices toward the level that would be set by intense competition,' by 'prevent[ing] retailers or wholesalers from reaping monopoly or supercompetitive profits'). Indeed, we acknowledged in *Albrecht* that '[m]aximum and minimum price fixing may have different consequences in many situations.' *Id.*, at 152. The procompetitive potential of a vertical maximum price restraint is more evident now than it was when *Albrecht* was decided, because exclusive territorial arrangements and other nonprice restrictions were unlawful *per se* in 1968. See *id.*, at 154; *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, 375-376 (1967). These agreements are currently subject only to rule-of-reason scrutiny, making monopolistic behavior by dealers more likely. See *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752, 761 (1984); *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 47-59 (1977).

"Many commentators have identified procompetitive effects of vertical maximum price fixing." 495 U.S. at 343, n.13 (citations omitted).

The newspaper industry is a good example of the potential for such procompetitive effects, and the absence of unequivocal anticompetitive effects. For this industry it creates a legal anomaly to view vertical maximum price-fixing as *per se* unlawful. The practice should be the subject of more careful inquiry as to competitive effects and market realities, which is to say evaluation under the Rule of Reason.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the judgment below should be reversed, and the case remanded with instructions to evaluate the challenged conduct under the Rule of Reason.

Respectfully submitted,

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April 4, 1997

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Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF OF THE AMERICAN PETROLEUM INSTITUTE AS *AMICUS CURIAE* SUPPORTING PETITIONER

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QUESTION PRESENTED

Amicus curiae American Petroleum Institute will address the following question:

Whether the Court should reconsider its conclusion in *Albrecht v Herald Co.*, 390 U.S. 145 (1968), that a purely vertical maximum resale price maintenance arrangement is a per se violation of Section 1 of the Sherman Act, 15 U.S.C. § 1?

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In The

Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-871

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN and KHAN & ASSOCIATES, INC.,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF OF THE AMERICAN PETROLEUM INSTITUTE AS *AMICUS CURIAE* SUPPORTING PETITIONER

INTEREST OF *AMICUS CURIAE*

The American Petroleum Institute ("API"), a non-profit District of Columbia corporation, is a national trade association. More than 300 companies are members and represent various facets of the petroleum industry: exploration, production, transportation, refining, and marketing. As is the case with the petitioner here, many of API's member companies are engaged in marketing petroleum products

through dealers. Thus API's members have a vital interest in this Court's review of the court of appeals' decision in this case.

API believes that its participation will provide the Court with a broader perspective on the principal question presented, and will help bring into focus the economic issues that underlie that antitrust question. All parties have consented to the filing of this brief.

STATEMENT

Respondents operated a gasoline service station in DuPage County, Illinois, under a contract with petitioner State Oil Company, a distributor of petroleum products. Petitioner leased the station to respondents, and supplied respondents with gasoline (sold under the Union 76 brand name) and related products. Pet. App. 1a-2a.

The contract between petitioner and respondent Khan provided that petitioner would suggest a retail price for gasoline, and would sell gasoline to respondents for 3.25 cents per gallon less than the suggested retail price. If respondents believed the suggested retail price was too high or too low, they could ask petitioner to change it. If petitioner changed the suggested price, respondents were entitled to purchase gasoline at 3.25 cents per gallon less than the revised suggested price. If petitioner declined to lower the suggested retail price, respondents remained free to charge a lower price and, by doing so, operate on a lower margin. If petitioner declined to raise the suggested retail price, respondents could charge a higher price, but in that event the contract provided that respondents were required to pay petitioner the difference between the suggested retail price and the actual retail price, multiplied by the number of gallons sold at the higher price. In effect, therefore, the contract required the rebating to petitioner of whatever revenues resulted from an increase above the suggested price. Pet. App. 2a.

Petitioner terminated respondents' contract for failing to pay rent due for the lease of the station. Respondents thereupon sued petitioner, alleging that petitioner had engaged in maximum resale price maintenance, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1 (1994). Respondents' complaint also alleged violations of the Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801-41 (1994), and breach of contract under Illinois law. Pet. App. 2a, 24a-25a.

The district court granted summary judgment for petitioner. Pet. App. 24a-42a. The district court concluded that the legality of the vertical maximum pricing restriction under the Sherman Act should be evaluated under the rule of reason, and that respondents had presented no evidence concerning essential elements of a rule of reason case, such as market power. *Id.* at 33a-40a. The district court also ruled that a study by plaintiffs' economic expert was inadmissible, and that absent this study plaintiffs could not show that they had been injured. *Id.* at 37a-40a.[1]

The court of appeals reversed the district court's ruling on the antitrust issue. Pet. App. 1a-20a. Chief Judge Posner's opinion for the court concluded that the rebate requirement effectively imposed a maximum resale price restriction. The court of appeals then followed this Court's decision in *Albrecht v. Herald Company*, 390 U.S. 145 (1968), which held that vertical maximum resale price fixing is a per se violation of Section 1 of the Sherman Act. Although the court of appeals concluded that "*Albrecht* was unsound when it was decided, . . . is inconsistent with later decisions by the Supreme Court . . . [and] should be overruled," Pet. App. 9a,

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[1] The district court rejected respondents' PMPA claim, on the ground that petitioner had not terminated respondents' franchise (Pet. App. 29a-33a), and also rejected respondents' state-law contract claim, on the ground that respondents offered no facts to support their legal claim (*id.* at 40a-42a).

it heeded this Court's admonitions that lower courts should not anticipate the overruling of a decision of this Court. *Id.* at 9a, citing *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989); *Thurston Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533, 535 (1983) (per curiam). Accordingly, the court of appeals reversed the entry of summary judgment for petitioner on the antitrust claim. Pet. App. 14a-15a.[2]

Judge Ripple wrote a concurring opinion emphasizing that this case presents "a wholly vertical arrangement . . . [with] no hint of any concrete horizontal effect." Pet. App. 17a.

SUMMARY OF ARGUMENT

This case presents the Court with an opportunity to reconsider whether a purely vertical maximum price restraint should be per se illegal under Section 1 of the Sherman Act. *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), which so holds, does not represent a deeply ingrained, oft-considered, oft-reiterated principle of antitrust law. *Albrecht*, rather, "is the only [prior] case in which the Court has confronted an unadulterated vertical, maximum-price-fixing arrangement." *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 336 n.6 (1990) ("*ARCO*").

Albrecht is an aberration that has been subjected to sustained and virtually unanimous negative criticism by scholarly commentators. Discussing *Albrecht* in their 1978 treatise, Phillip Areeda and Donald Turner stated that "[i]t seems most doubtful that the purposes of the antitrust laws are served by awarding damages for the impairment of the

[2] The court of appeals also held that the district court had abused its discretion in ruling inadmissible the report of respondents' economic expert (Pet. App. 11a-13a), and affirmed the dismissal of the state-law contract claim (*id.* at 14a-15a).

plaintiff's monopoly power over newspaper subscribers." Roger D. Blair & Gordon L. Lang, *Albrecht After ARCO: Maximum Resale Price Fixing Moves Toward the Rule of Reason*, 44 Vand. L. Rev. 1007, 1021 (1991), quoting 2 Phillip Areeda & Donald Turner, *Antitrust Law* ¶ 347 (1978). Another leading commentator has stated: "Few Supreme Court decisions have proved more anticompetitive than *Albrecht*." Herbert Hovenkamp, *Federal Antitrust Policy* § 11.5c at 422 (1994). Even defenders of the per se rule against minimum resale price fixing generally acknowledge that maximum vertical price fixing raises different issues that warrant rule of reason treatment.

This Court, as well as lower courts, has questioned the continued validity of *Albrecht*'s per se rule. This Court in *ARCO* candidly stated that maximum price fixing may in some circumstances protect consumers from exploitation, and that "the procompetitive potential of a vertical maximum price restraint is more evident now [in 1990] than it was when *Albrecht* was decided," pointing to the overruling of *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) by *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), and the increased possibility of dealer market power derived from lawful exclusive territories. 495 U.S. at 343 n.13.

Albrecht, like *Schwinn*, placed heavy reliance on the proposition that any restraint on the freedom of a dealer to compete as it wishes is per se illegal. But this Court has rejected that proposition since *Albrecht*. In addition, *Albrecht* is difficult to reconcile with *ARCO* and other decisions of this Court applying the doctrine of antitrust injury, which have recognized that non-predatory "[l]ow prices benefit consumers regardless of how [they] are set," and "do not threaten competition." 495 U.S. at 340.

In view of these developments in the law, maximum vertical price fixing is no longer a proper subject for per se treatment — *i.e.*, it is now clearly *not* the case that application of the rule of reason would be futile because the Court can predict with confidence that the rule of reason will condemn the practice. The Court should expressly overrule *Albrecht*, and establish that maximum resale price maintenance is subject to analysis under the rule of reason.

ARGUMENT

I. THE PER SE RULE, WHICH IS RESERVED FOR CONDUCT THAT ALWAYS OR ALMOST ALWAYS HAS ANTICOMPETITIVE EFFECTS, SHOULD NOT BE APPLIED TO MAXIMUM VERTICAL PRICE MAINTENANCE, WHICH THE COURT HAS RECOGNIZED MAY BE PROCOMPETITIVE.

The Court has held repeatedly that Section 1 of the Sherman Act was intended to prohibit only *unreasonable* restraints of trade. *See, e.g., Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988) (citing additional cases). In determining whether a particular restraint is reasonable, the Court's inquiry "is confined to a consideration of impact on competitive conditions." *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 690 (1978). "Ordinarily, whether particular concerted action violates § 1 of the Sherman Act is determined through case-by-case application of the so-called rule of reason — that is, 'the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.'" *Business Electronics*, 485 U.S. at 723, quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977). "[T]here is a presumption in favor of a rule-of-reason standard." *Business Electronics*, 485 U.S. at 726.

Although the Court has departed from the presumption in favor of a rule of reason standard and has held that certain categories of agreements are illegal per se, thus "dispensing with the need for case-by-case evaluation," 485 U.S. at 723, the Court has reserved the per se rule for "'conduct that is manifestly anticompetitive,'" *i.e.*, conduct "'that would always or almost always tend to restrict competition and decrease output.'" *Id.*, quoting *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985), quoting, in turn, *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19-20 (1979). As the Court stated in *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 344 (1982), "[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable."

The Court has accordingly applied the per se rule to horizontal price-fixing agreements, *see FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 421-23 (1990); *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397-98 (1927), as well as to horizontal agreements dividing territories, *see Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46, 49 (1990); *United States v. Topco Assocs., Inc.*, 405 U.S. 596, 608 (1972). The per se rule against horizontal price-fixing also has been applied to agreements among competitors setting minimum or maximum resale prices. As Professor Areeda has noted, "competitors have so strong an incentive to escape price competition that it is exceedingly dangerous to allow them to discuss and come to *any* kind of consensus about prices." 8 Phillip E. Areeda, *Antitrust Law* ¶ 1637c, at 405 n.11 (1989).[3]

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[3] The court of appeals' opinion suggests that competitors' agreements to fix minimum resale prices may be motivated by a desire to prevent cheating on their horizontal price-fixing cartel, and that agreements among

These are all horizontal arrangements among competitors. The Court has expressly recognized a distinction between horizontal and vertical restraints. It has stated that "the scope of *per se* illegality should be narrow in the context of vertical restraints," *Business Electronics*, 485 U.S. at 724, because "[v]ertical restrictions promote interbrand competition," which is "the primary concern of antitrust law." *Sylvania*, 433 U.S. at 52 n.19, 54.

To be sure, the Court has adhered to the per se rule against vertical *minimum* resale price maintenance, which was established in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). *See Business Electronics*, 485 U.S. at 724-26; *Sylvania*, 433 U.S. at 51 n.18. But, as discussed at p. 9, *infra*, this Court has now acknowledged, given *Sylvania*, the possible procompetitive impact of maximum retail price maintenance. *ARCO*, 495 U.S. at 343 n.13. Moreover, as this Court explained in *Dr. Miles*, *Sylvania*, and *Business Electronics*, the bases for its concern with vertical price fixing were the possibilities that such arrangements may serve to organize dealer-level cartels, or to deter cheating on a price-fixing cartel at the supplier level. *See Business Electronics*, 485 U.S. at 725-26. But maximum resale price maintenance, unlike minimum resale price maintenance, does not prevent retailers from competing among themselves as to price, and because dealer price cuts are possible does not serve to prevent cheating by members of a supplier cartel.

Hence, *Albrecht*'s per se rule against vertical maximum resale price maintenance rests on far shakier economic and precedential foundations than it once did. It is clearly no longer the case, if it ever was, that a court can predict with

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competitors on maximum resale prices may be designed to reduce dealer margins. Pet. App. 4a-5a.

confidence that the rule of reason will condemn a vertical maximum resale price arrangement.

II. THE PER SE RULE OF *ALBRECHT* IS INCONSISTENT WITH THIS COURT'S SUBSEQUENT ANTITRUST DECISIONS.

Albrecht's extension of the per se rule to vertical maximum price restraints is an aberration. *Albrecht* is the only decision of this Court that has applied a rule of per se illegality to "an unadulterated vertical, maximum-price-fixing arrangement." *ARCO*, 495 U.S. at 336 n.6.[4] The Court's doubt as to its continued validity in the face of later developments is indicated in *ARCO*, where this Court merely "assume[d], *arguendo*, that *Albrecht* correctly held that vertical, maximum price fixing is subject to the per se rule." 495 U.S. at 335 n.5. *ARCO* itself expressly recognized (1) that vertical maximum price maintenance "may have procompetitive interbrand effects," *Id.* at 343 n.13, (2) that "the procompetitive potential of a vertical maximum price restraint is more evident now than it was when *Albrecht* was decided, because exclusive territorial arrangements and other nonprice restrictions were unlawful *per se* in 1968," *id.*, citing *Schwinn*, 388 U.S. 365, 375-76 (1967); and (3) that non-price vertical agreements now are subject "only to rule-of-reason scrutiny, making monopolistic behavior by dealers more likely." 495 U.S. at 343 n.13.

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[4] *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951), by contrast, presented "an additional horizontal component." *ARCO*, 495 U.S. at 336 n.6. Although the two suppliers in *Kiefer-Stewart* were owned by a common parent, and therefore would not be regarded as capable of conspiring with each other for purposes of Section 1 today, *see Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984), they were treated as competitors in *Kiefer-Stewart*. *See* 340 U.S. at 215.

In addition, a per se rule against maximum resale price restrictions is in several ways inconsistent with this Court's decision in *Sylvania*. *Albrecht* was decided one year after *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). The Court's decisions in *Albrecht* and *Schwinn* both turned in large part on the proposition that the antitrust laws protect "dealer freedom," and that restraints on alienation — *i.e.*, on the dealer's freedom to resell as it wishes — should be per se violations of the antitrust laws. *See* 390 U.S. at 152; 388 U.S. at 379-80.

In *Sylvania*, however, the Court overruled *Schwinn*'s per se rule against vertical territorial restrictions. In rejecting *Schwinn*, *Sylvania* expressly rejects many of the reasons the Court gave for its decision in *Albrecht*.[5]

First, *Sylvania* expressly rejects the "dealer freedom" rationale that provided the essential underpinning for *Albrecht*. The Court forthrightly declared that "the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today." 433 U.S. at 53 n.21, quoting *Schwinn*, 388 U.S. at 392 (Stewart, J., dissenting).[6]

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[5] As a leading commentator observes, *Sylvania* "explicitly or implicitly undercut every rationale for the per se rule offered in *Albrecht*, with the exception of the 'disguised minimum' concern." 8 Phillip E. Areeda, *Antitrust Law* ¶ 1638c (1989).

[6] The Court observed that its "isolated reference" in *Schwinn* to "the ancient rule against restraints on alienation" had "provoked sharp criticism from virtually all of the commentators," who "regarded the Court's apparent reliance on the 'ancient rule' as both a misreading of legal history and a perversion of antitrust analysis." 433 U.S. at 53 n.21 (citations omitted). *See also* Herbert Hovenkamp, *Federal Antitrust Policy* § 11.5a (1994) (restraints on alienation were not illegal at common law; by the time of *Dr. Miles*, resale price maintenance agreements were both legal and enforceable, unless the supplier had a large market share and the agreement was used to facilitate horizontal price-fixing) (citations omitted).

Second, *Sylvania* rejects *Albrecht*'s leap from the per se illegality of *horizontal* maximum price agreements to the per se illegality of *vertical* maximum price agreements. *Sylvania* draws a sharp distinction between horizontal restrictions and vertical restrictions. The Court later reaffirmed the importance of this distinction in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), and *Business Electronics*. Although *Sylvania* noted the per se illegality of vertical price fixing, 433 U.S. at 51 n.18, it is clear that in context the reference to established per se illegality was to *minimum* resale price maintenance which was thought to facilitate cartelization of dealers and suppliers. *See* p. 8, *supra*.[7]

Third, *Sylvania* "make[s] clear that departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than — as in *Schwinn* — upon formalistic line drawing." 433 U.S. at 58-59. In *Business Electronics*, the Court's decision expressly notes that imposing the per se rule on vertical restrictions merely because they contain the word "price" is the type of "formalism [that] was explicitly rejected in *GTE Sylvania*." 485 U.S. at 728. Hence, the fact that maximum resale price restrictions "directly" involve price in and of itself provides no demonstrable economic basis for invoking the per se rule. As

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[7] In commenting on *Sylvania*, then-Professor Pitofsky observed that the *Sylvania* reason for adhering to the per se rule against vertical price fixing, which focused "principally on its tendency to stabilize supplier price levels," undermined the *Albrecht* per se ruling since in *Albrecht* "[t]here was no suggestion, as indeed there could not be, that maximum price fixing would be likely to stabilize a supplier cartel." Robert Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 Colum. L. Rev., 1, 16, n.59 (1978).

the Court noted in *Business Electronics* in rejecting an effort to apply the per se rule to vertical restraints that contain the word "price" or that affect retail prices, "all vertical restraints, including the exclusive territory agreement held not to be *per se* illegal in *GTE Sylvania*, have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that." 485 U.S. at 728.

Fourth, *Sylvania* recognizes that suppliers generally have an incentive to impose socially optimal restrictions on dealers, thus undermining *Albrecht*'s concern that suppliers will impose the "wrong" price. *See also Business Electronics*, 485 U.S. at 726 ("interbrand competition is the primary concern of the antitrust laws").

Fifth, *Sylvania*'s recognition that territorial restrictions often are procompetitive and lawful under the antitrust laws increases the procompetitive potential of maximum price restraints, because "exclusive territorial arrangements . . . mak[e] monopolistic behavior by dealers more likely." *ARCO*, 495 U.S. at 343 n.13.

In sum, *Albrecht*, like *Schwinn*, has been the subject of sustained and uniform criticism, both in scholarly commentary and in the courts.[8] *Schwinn* was an abrupt departure from the Court's prior precedents, that was corrected by *Sylvania*. *See* 433 U.S. at 47. *Albrecht* remains as an isolated precedent, issued in the penumbra of *Schwinn*, that resulted from the Court's brief willingness to deploy the per se rule to implement a formalistic antipathy towards restraints on alienation.

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[8] *See infra* note 9.

III. MAXIMUM RESALE PRICES OFTEN HAVE PROCOMPETITIVE EFFECTS AND RARELY HAVE ANTICOMPETITIVE EFFECTS.

1. Maximum Resale Prices Often Have Procompetitive Effects.

As noted earlier, p. 9, *supra*, in *ARCO* the Court acknowledged that vertical maximum price restraints may be procompetitive: "When a manufacturer provides a dealer an exclusive area within which to distribute a product, the manufacturer's decision to fix a maximum resale price may actually protect consumers against exploitation by the dealer acting as a local monopolist." 495 U.S. at 343 n.13. The Court cited some of the "[m]any commentators [who] have identified procompetitive effects of vertical, maximum price fixing." 495 U.S. at 343 n.13.[9]

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[9] In addition to the authorities cited in *ARCO*, *see* Areeda, *supra*, ¶¶ 1634-40 (1989 & 1995 Supp.); ABA Antitrust Section, Monograph No. 2, *Vertical Restrictions Limiting Intrabrand Competition* 77-96 (1977); F.M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 558 (3d ed. 1990); Roger D. Blair & Amanda K. Esquibel, *Maximum Resale Price Restraints in Franchising*, 65 Antitrust L.J. 157 (1996);Roger D. Blair & James M. Fesmire, *Maximum Price Fixing and the Goals of Antitrust*, 37 Syracuse L. Rev. 43 (1986); Roger D. Blair & David L. Kaserman, *The Albrecht Rule and Consumer Welfare: An Economic Analysis*, 33 U. Fla. L. Rev. 461 (1981); Roger D. Blair & Gordon L. Lang, *Albrecht After ARCO: Maximum Resale Price Fixing Moves Toward the Rule of Reason*, 44 Vand. L. Rev. 1007 (1991); Stephen Calkins, *The October 1989 Supreme Court Term and Antitrust: Power, Access, and Legitimacy*, 59 Antitrust L.J. 339 (1991); Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135 (1984); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263 (1991); Robert J. Larner, *Vertical Price Restraints: Per Se or Rule of Reason?*, in *Economics & Antitrust Policy* 123 (Robert J. Larner & James W. Meehan, Jr., eds., 1989); Fritz Machlup & Martha Taber, *Bilateral Monopoly, Successive Monopoly, and Vertical Integration*, 27 Economica 101 (1960); William H.

Maximum resale prices can be procompetitive when dealers possess some degree of market power, whether because the dealer occupies a strategic physical location or because the supplier, itself with some market power, sells to relatively few dealers or grants dealers exclusive territories.[10]

A dealer with market power can be expected to exercise it by raising prices leading to reduced sales. Such higher prices harm consumers. The reduced sales harm the supplier, who does not share in the dealer's supracompetitive profits. In this situation, a maximum price restriction is a procompetitive means for suppliers, pursuing their own interests, to prevent dealers from gouging consumers.

In view of the *Albrecht* per se ban, a supplier may turn to other ways to prevent dealers from charging supracompetitive

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Page, *The Scope of Liability for Antitrust Violations*, 37 Stan. L. Rev. 1445 (1985); William H. Page, *Antitrust Damages and Economic Efficiency: An Approach to Antitrust Injury*, 47 U. Chi. L. Rev. 467 (1980).

Even those who support retention of the per se rule against minimum resale price maintenance acknowledge that maximum resale price maintenance requires a different analysis. *See, e.g.*, Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1490 (1983) (maximum vertical price fixing "probably *should* be treated under a rule of reason") (citing Frank Easterbrook, *Maximum Price Fixing*, 48 U. Chi. L. Rev. 886 (1981)).

[10] The fact that a supplier may have market power (*e.g.*, arising from brand differentiation) does not detract from the pro-competitive impact of maximum resale price maintenance. In many instances, supplier market power does not violate the antitrust laws. *See United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) (Section 2 of the Sherman Act is not violated if market power is "a consequence of a superior product, business acumen, or historic accident"). Whether or not the supplier's market power is viewed as undesirable, there is no reason "to allow an *additional* and *unnecessary* monopoly toll on society that a manufacturer wishes to prevent." 8 Phillip E. Areeda, *Antitrust Law* ¶ 1636b, at 397 (1989).

prices. A supplier might integrate vertically, either taking over the entire retailing function itself or competing with its dealers through a dual distribution system. *See Sylvania*, 433 U.S. at 57 n.26 (per se rules may "create[] an incentive for vertical integration into the distribution system, thereby eliminating to that extent the role of independent businessmen"); *see also* Blair & Esquibel, *supra*, at 169-72. The supplier might in the alternative appoint more dealers, or eliminate territorial or customer restrictions that limit intrabrand competition. Or the supplier might resort to indirect methods, such as advertising a suggested retail price (to increase consumer resistance to higher prices), or imposing a sales quota on its dealers.[11]

Each of these options may well be less efficient than a system of independent dealers operating under a maximum price constraint. As the Court recognized in *ARCO*, "[i]f an exclusive dealership is the most efficient means of distribution, the public is not served by forcing the manufacturer to abandon this method and resort to self-distribution or competing distributors." 495 U.S. at 343 n.13. Moreover, some of the options may simply be unavailable to some suppliers. For example, if distribution is a "natural monopoly," a supplier will not be able to appoint more dealers or adopt a dual distribution system. And if dealers carry multiple products or multiple brands, vertical integration may not be possible.

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[11] The supplier might also attempt to establish a consignment arrangement with the dealer. *See United States v. General Elec. Co.*, 272 U.S. 476 (1926). In *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964), however, the Court held that the supplier was liable under Section 1 despite a consignment arrangement, because the nominal consignees possessed many of the indicia of ownership. *But cf. Sylvania*, 433 U.S. at 56 (recognizing that the "distinction between sale and nonsale transactions is essentially unrelated to any relevant economic impact").

2. Vertical Resale Price Ceilings Are Unlikely To Have Anticompetitive Effects.

Even in *Albrecht*, the Court recognized that "[m]aximum and minimum price fixing may have different consequences in many situations." 390 U.S. at 152. As many commentators have recognized, maximum resale prices do not present the same anticompetitive dangers as minimum resale prices: a minimum price prevents intrabrand price competition below a price floor set by the supplier; a maximum price ordinarily allows intrabrand price competition below the supplier's price ceiling. Thus, a price ceiling, unlike a price floor, does not insulate dealers from competition and cannot be used to organize a dealer cartel or deter cheating by members of a supplier cartel. *See, e.g.* Areeda, *supra*, ¶ 1637b.

Accordingly, a per se rule against maximum resale prices cannot be justified simply by analogy to the per se rule against minimum resale prices. *See Business Electronics*, 485 U.S. at 726 (departures from the rule of reason "must be justified by demonstrable economic effect . . . rather than formalistic distinctions").

The Court's opinion in *Albrecht* did not rely on the cartel-creation or cartel-facilitation explanations identified in *Dr. Miles*, *Sylvania*, and *Business Electronics* as the bases for invalidation of vertical price fixing. Rather, the *Albrecht* opinion suggests several other possible anticompetitive consequences of maximum resale price restrictions. 390 U.S. at 152-53. Upon analysis, however, none of the consequences hypothesized by the Court in *Albrecht* appears likely. Most have been implicitly or explicitly rejected after detailed analysis by subsequent decisions.

i. *"Dealer Freedom."* The *Albrecht* Court's decision relies in large part on its statement that maximum resale prices would "cripple the freedom of traders." 390 U.S. at 152, quoting *Kiefer-Stewart Co.*, 340 U.S. at 213. This rationale,

which was a cornerstone of the Court's decision in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379-80 (1967), as well as the decision in *Albrecht*, was, as noted above, p. 10, decisively rejected in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), which overruled *Schwinn*.

ii. *Setting Prices "Too Low" and Restricting Dealer Services.* In *Albrecht*, the Court expressed concern that "[m]aximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which consumers desire and for which they are willing to pay. 390 U.S. at 152-53. There are several reasons why this concern is misplaced and in any event does not warrant a rule of per se illegality. *See* Areeda, *supra*, ¶ 1637e-f.

Suppliers have no incentive to set a price that is too low, because in so doing they decrease their own profits. The Court in *Sylvania* acknowledged the economic arguments that suppliers generally have an incentive to impose socially optimal restrictions on their dealers. 433 U.S. at 56 & n.24. If the supplier makes a mistake, it is likely to be self-correcting. If the price is too low to permit dealers to earn a competitive rate of return, dealers will not be willing to continue carrying the product. And if the price is too low to permit dealers to provide services that consumers want and are willing to pay for, the supplier will soon find that consumers are switching to competing products that are sold with the desired services, or are simply buying less of the supplier's product. Moreover, dealers as well as suppliers may make pricing mistakes.

iii. *Limiting the number of dealers.* The *Albrecht* opinion observed that "[m]aximum price fixing may channel distribution through a few large or specifically advantaged dealers who otherwise would be subject to significant nonprice

competition." 390 U.S. at 153. This seems to suggest that maximum prices may be set so low that only a few dealers can survive. But it is not clear why a supplier, having established a distribution network, would find it in its interest to render a number of its distributors inoperative through a penalizingly low maximum. Consequently, the Court's concern about "channeling" distribution is just another way of suggesting that, as discussed above, the supplier may mistakenly set a price that is "too low." *See* Areeda, *supra*, ¶ 1637g.

iv. *Maximum Price as a "Disguised Minimum" Price.* *Albrecht* also observed that "if the actual price charged under a maximum price scheme is nearly always the fixed maximum price, which is increasingly likely as the maximum price approaches the actual cost of the dealer, the scheme tends to acquire all the attributes of an arrangement fixing minimum prices." 390 U.S. at 153. In practice, however, it would be difficult for a supplier to impose a "disguised" minimum resale price in the form of a maximum resale price. If the supplier did not impose sanctions for selling below the maximum price, the "disguised minimum price" would amount to no more than a suggested retail price, which is lawful. If the supplier disciplined dealers who sold below the maximum price, it would be evident in most cases that the ostensible maximum price is in fact an illegal minimum price. The issue in this case is whether a vertical maximum should be illegal per se; it is not whether a vertical maximum is to be legal per se even if it is a de facto vertical minimum. *See* Areeda, *supra*, ¶ 1637c.

v. *Other Possible Anticompetitive Effects are Non-existent or Negligible.* Although not referred to by the *Albrecht* opinion, a maximum resale price conceivably could be used as part of a predatory pricing scheme. But predatory pricing may itself be a violation of the antitrust laws, *see Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 117-18 (1986), and a per se ban on vertical maximum price maintenance is not justifiable as needed to police predation. *See* Areeda, *supra*, ¶ 1637h.

Maximum prices might be argued to be a method of "exploiting" dealers by requiring them to sell at a loss. However, in the long run the supplier will not be able to require the dealer to accept less than a competitive return for its services; the dealer will switch to other brands or go out of business. Even in the short-run, a price ceiling would not harm consumers, and even the dealer may be better off living with the ceiling if the supplier, driven by its marketing concerns to lower the resale price, had as a legal alternative course of action cutting the dealer off immediately. *See* Areeda, *supra*, ¶ 1637i.

Finally, there are circumstances in which maximum prices might be imposed as part of a price discrimination scheme. Again, however, the possible benefits of discouraging price discrimination (for which the Robinson-Patman Act may provide relief) cannot justify a per se rule of illegality. *See* Areeda, *supra*, ¶ 1637j.

IV. THE *ALBRECHT* PER SE RULE IS INCONSISTENT WITH THE SUBSEQUENTLY DEVELOPED ANTITRUST INJURY DOCTRINE.

The post-*Albrecht* development of the doctrine of antitrust injury has spotlighted the inadequacies of the *Albrecht* per se rule. Beginning with *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977), the Court held that a plaintiff in an antitrust case must show "*antitrust* injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts

unlawful."[12] In *ARCO*, 495 U.S. 328 (1990), the Court held that a competing dealer suffers no antitrust injury when as a result of vertical maximum price fixing his competitors charge a lower but non-predatory price. The Court reasoned that "[t]o hold that the antitrust laws protect competitors from the loss of profits due to [nonpredatory] price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share." *Id.* at 338. The Court further stated that this would contradict the basic principle that "[t]he antitrust laws were enacted for 'the protection of *competition*, not *competitors*.'" *Id.*, quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962) (emphasis in original). In addition, the Court observed in *ARCO*: "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition." 495 U.S. at 340. Given the Court's belief expressed in *ARCO* that low non-predatory prices benefit consumers and do not threaten competition, it is hardly clear what the "antitrust injury" of a dealer subject to a vertical maximum price constraint could be.

The Court's decision in *ARCO* assumed, "*arguendo*, that *Albrecht* correctly held that vertical, maximum price-fixing is subject to the *per se* rule", 495 U.S. at 335 n.5, and accordingly assumed that in some way the "potential effects on dealers" identified in *Albrecht* would qualify as antitrust injury. 495 U.S. at 336. For the reasons explained above, however, maximum resale price maintenance is primarily procompetitive. While there may be occasional instances in which one could contrive a theory of antitrust injury assuming the validity of *Albrecht*, the difficulty in finding instances in

[12] *See also Cargill*, 479 U.S. at 109-110; *Associated Gen. Contractors v. California State Council of Carpenters*, 459 U.S. 519, 539-40 (1983); *Blue Shield v. McCready*, 457 U.S. 465, 483 & n.19 (1982); *J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 562 (1981).

which the antitrust injury requirement is met indicates that the practice is frequently not anticompetitive and demonstrates that a rule of per se illegality is inappropriate.[13]

The fact that a variety of cases in which plaintiffs invoked the *Albrecht* per se rule have foundered for lack of antitrust injury or injury in fact[14] strongly suggests that the per se rule is an empty shell and should be abandoned.

[13] In *Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft*, 19 F. 3d 745 (1st Cir. 1994), the First Circuit, governed by the decision in *Albrecht*, dutifully speculated on the possibility that a dealer who could have profited by providing services to improve the value of the product had there been no ceiling could recover the profits associated with lost sales. At the same time that court observed that insofar as plaintiff's claim merely refers to "'losses' that occurred because the agreement prevented Caribe from raising prices above the competitive level, it is at least arguable that no 'antitrust injury' occurred." *Id.* at 753-54 (citation omitted).

[14] *See Indiana Grocery, Inc. v. Super Valu Stores, Inc.*, 864 F.2d 1409 (7th Cir. 1989) (competing dealer lacks antitrust standing to challenge maximum resale prices); *Northwest Publications, Inc. v. Crumb*, 752 F.2d 473 (9th Cir. 1985) (plaintiffs would not have raised prices absent a maximum price restriction, because they had the sophistication to understand that they would have been terminated); *Jack Walters & Sons Corp. v. Morton Bldg., Inc.*, 737 F.2d 698, 706 (7th Cir.) (suggesting that "a manufacturer-imposed price ceiling intended to limit the power that exclusive territories give dealers to raise prices" may be lawful despite *Albrecht*), *cert. denied*, 469 U.S. 1018 (1984); *Knutson v. Daily Review, Inc.*, 548 F. 2d 795 (9th Cir. 1976) (dealers entitled only to nominal damages, because given their knowledge of the newspaper business, they would not have raised prices even if they had been free to do so), *cert. denied*, 433 U.S. 910 (1977); *Newberry v. Washington Post Co.*, 438 F. Supp. 470 (D.D.C. 1977) (plaintiffs entitled only to nominal damages, because there is no proof that they would have raised their prices absent a maximum price restriction, and no proof of the subscribers' response to a price increase).

V. THE DOCTRINE OF *STARE DECISIS* DOES NOT REQUIRE THE COURT TO ADHERE TO *ALBRECHT*.

The doctrine of *stare decisis* is a "principle of policy," *Helvering v. Hallock*, 309 U.S. 106, 119 (1940), and not an "inexorable command," *Payne v. Tennessee*, 501 U.S. 808, 828 (1991). Although the Court generally is reluctant to overrule its statutory precedents, on the ground that "Congress is free to change this Court's interpretation of its legislation," *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977), the Court has not hesitated to overrule its statutory precedents "when the intervening development of the law has 'removed or weakened the conceptual underpinnings from the prior decision, or where the later law has rendered the decision irreconcilable with competing legal doctrines or policies.'" *Neal v. United States*, 116 S. Ct. 763, 769 (1996), quoting *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989). As explained above, the conceptual underpinnings of *Albrecht* have been destroyed by the Court's subsequent decisions concerning vertical restraints.

Furthermore, Section 1 of the Sherman Act is not an ordinary statute. It is "the Magna Carta of free enterprise, as important to the . . . free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms." *United States v. Topco Associates, Inc.*, 405 U.S. 596, 610 (1972). Because Congress did not define the term "restraint of trade," the Court has properly regarded the Sherman Act as inviting the Court to take a common-law approach. *See, e.g.*, Herbert Hovenkamp, *Economics and Federal Antitrust Law* § 2.4, at 52-53 (1985). Many basic legal principles under Section 1 — including the distinction between horizontal and vertical agreements, the distinction between the per se rule and the rule of reason, and the principle that Section 1 forbids only unreasonable restraints of trade — were developed by this Court. The Court thus

should be more willing to reconsider one of its precedents in this area than it would be to reconsider a precedent interpreting a narrower statute, more recently enacted or as to which there is a history of congressional amendment of basic statutory language, and not the subject of an extensive body of judicial precedent developed by this Court.[15]

Accordingly, the Court should overrule *Albrecht*, and hold that vertical maximum resale price maintenance is subject to analysis under the rule of reason.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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April 1997

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[15] Although Congress has legislated with respect to minimum resale price maintenance — first authorizing States to permit minimum resale price maintenance in the Miller-Tydings Act of 1937, Pub. L. No. 75-314, 50 Stat. 693, and then withdrawing that authorization in the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801 — it has never enacted legislation addressing *maximum* resale price maintenance.

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No. 96-871

In the Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY, PETITIONER

v.

BARKAT U. KHAN, ET AL., RESPONDENTS

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR THE AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION AND THE ASSOCIATION OF INTERNATIONAL AUTOMOBILE MANUFACTURERS, INC. AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

This brief addresses only the second question presented in the petition for a writ of certiorari:

Whether maximum resale price maintenance should continue to be prohibited *per se* under the antitrust laws.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-871

STATE OIL COMPANY, PETITIONER
v.
BARKAT U. KHAN, ET AL., RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE AMERICAN AUTOMOBILE MANUFACTURERS ASSOCIATION AND THE ASSOCIATION OF INTERNATIONAL AUTOMOBILE MANUFACTURERS, INC. AS AMICI CURIAE SUPPORTING PETITIONER

INTEREST OF THE AMICI CURIAE

The American Automobile Manufacturers Association ("AAMA") is a non-profit national trade organization. Its member companies — General Motors Corporation, Ford Motor Corporation, and Chrysler Corporation — are the largest automobile manufacturers in the United States. The Association of International Automobile Manufacturers, Inc. ("AIAM") is a trade association organized as a non-profit Virginia corporation representing United States subsidiaries of international automobile manufacturers that sell vehicles in the United States that are

manufactured both here and abroad.[1] The AAMA and AIAM have often represented their members before this Court and other tribunals.[2]

This case presents the Court with the opportunity to revisit the *per se* prohibition of maximum resale price maintenance under the antitrust laws. Maximum resale price maintenance — that is, a manufacturer's imposition of a ceiling on the retail price of its goods — is an important competitive weapon for manufacturers that face intense interbrand competition but distribute their products to the public primarily through independent dealers. The issue presented in this case is of substantial importance to the members of the AAMA and the AIAM because each distributes its vehicles primarily through networks of independently owned local dealers.

Amici support the views presented below with examples from their experience competing in an industry marked by intense interbrand competition at the producer level. It is their experience that price competition among manufacturers can be diminished by intermediary dealers whose interests may not always coincide with the competitive needs of the manufacturers. Maximum resale price maintenance provides an effective way for manufacturers to ensure that the benefits of interbrand competition are passed through to consumers. For that reason, and because of the unlikelihood that maximum resale price

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[1] The members of the AIAM include American Honda Motor Co. Inc., American Suzuki Motor Corporation, BMW of North America, Inc., Daewoo Motor Co., Ltd., Fiat Auto U.S.A., Inc., Hyundai Motor America, Isuzu Motors America, Inc., Mazda Motor of America, Inc., Mitsubishi Motor Sales of America, Inc., Nissan North America, Inc., Peugeot Motors of America, Inc., Porsche Cars North America, Inc., Rolls-Royce Motor Cars, Inc., Saab Cars USA, Inc., Subaru of America, Inc., Toyota Motor Sales U.S.A., Inc., Volkswagen of America, Inc., and Volvo North America Corporation.

[2] Pursuant to Sup. Ct. R. 37, letters from the parties consenting to the filing of this brief have been filed with the Clerk of the Court.

maintenance has any anticompetitive effects, rule-of-reason treatment of maximum resale price maintenance is appropriate as a matter of antitrust law and policy. Furthermore, such treatment is likely to produce tangible consumer benefits in the sale of automobiles.

INTRODUCTION AND SUMMARY OF ARGUMENT

The continued *per se* condemnation of maximum resale price maintenance is a triumph of formalistic labeling over substance, because price ceilings almost always benefit consumers. By no stretch of the imagination does a practice that tends to reduce prices in a single brand cause competitive harm in the run of cases. Indeed, it is unlikely that maximum resale price maintenance in itself causes any competitive harm.

Without confirmed anticompetitive effects, maximum resale price maintenance has no place in the narrow class of *per se* offenses. Rather, the practice should be presumptively permissible under the rule of reason. But there is another powerful reason to permit the practice whenever it survives rule-of-reason analysis. As we explain below, the *per se* prohibition deters substantial procompetitive behavior by preventing manufacturers from ensuring that economic incentives offered at the wholesale level in fact reach the targeted consumers who determine the competitive outcome. Vertical price ceilings (and similar devices that require wholesale price reductions to be passed through to consumers) can both hold down consumer prices and intensify interbrand competition among automobile manufacturers. The effect of those techniques is greatly weakened, to the point of discouraging their use, when they cannot be enforced effectively.

Finally, concerns about *stare decisis* should not prevent this Court from reconsidering and abandoning *per se* treatment of maximum resale price maintenance. The history of the antitrust laws reflects an evolution of common-law doctrines. For the same reason that this Court hesitates to create new *per se* rules without a conclusive demonstration that a practice is

anticompetitive in all but the exceptional case, the Court should not leave in place a *per se* rule proscribing an activity that demonstrably will benefit consumers in many instances and harm them in few. Maximum resale price maintenance should be returned to the repertoire of business practices that are permissible unless proved anticompetitive, and *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968), therefore should be overruled.

ARGUMENT

Antitrust law is driven by — not incompatible with — profit-seeking activity. The "prevailing standard of analysis" under the antitrust laws is the rule of reason, which condemns only restrictive practices that are proved to be anticompetitive in a particular case. *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 49 (1977). This Court has condemned a handful of business practices *per se*, but only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Arizona* v. *Maricopa County Medical Society*, 457 U.S. 332, 343-344 (1982).

The decision in *Albrecht* v. *Herald Co.* was supported by no such confident prediction. Rather, the Court relied on a rigid view that any price restraint, even a vertical restraint that only lowered the price of a single brand, must be proscribed no matter how much it helped consumers. Experience and analysis show that maximum resale price maintenance rarely, if ever, injures consumers. The costs of the *Albrecht* rule to consumers and manufacturers alike are substantial, while the benefits to consumers are imperceptible if they exist at all.

I. *PER SE* CONDEMNATION OF MAXIMUM RESALE PRICE MAINTENANCE CONFLICTS WITH MODERN ANTITRUST POLICY AND PRECEDENT

This Court now limits *per se* illegality under the antitrust laws to "conduct that is manifestly anticompetitive, that is, conduct that would always or almost always tend to restrict

competition and decrease output." *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988) (citations and internal quotation marks omitted). To meet that standard, a practice must both have a "pernicious effect on competition" **and** "lack * * * any redeeming virtue." *GTE Sylvania*, 433 U.S. at 50 (quoting *Northern Pacific Ry.* v. *United States*, 356 U.S. 1, 5 (1958)). *Per se* condemnation cannot rely on the uncritical application of familiar labels, but must be rooted in the realities of the marketplace: a "departure from the rule-of-reason standard must be based on demonstrable economic effect rather than * * * formalistic line drawing." *Id.* at 58-59.

Maximum resale price maintenance cannot conceivably be condemned *per se* under those "demanding standards." *GTE Sylvania*, 433 U.S. at 50. Far from having a "pernicious effect," the imposition of price ceilings by individual manufacturers can only intensify interbrand competition by limiting the amount added to a competitive wholesale price in the course of retail distribution. And the "redeeming virtue" of price ceilings is obvious. As Justice Brennan wrote for this Court, "Low prices benefit consumers regardless of how those prices are set." *Atlantic Richfield Co.* v. *USA Petroleum Co.*, 495 U.S. 328, 340 (1990) ("*ARCO*"). That is true "regardless of the type of antitrust claim involved." *Ibid.* See also *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993).

The continued *per se* treatment of maximum resale price maintenance — which "always or almost always" poses no anticompetitive threat at all, and tends to increase demand and therefore output by lowering distribution costs — stands the test for *per se* treatment on its head. See Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981). The Court should correct this anomaly in the antitrust laws and return maximum resale price maintenance to rule-of-reason analysis.

A. This Court recently acknowledged that "[t]he procompetitive potential of a vertical maximum price restraint

is more evident now than it was when *Albrecht* was decided." *ARCO*, 495 U.S. at 343 n. 13. Indeed, economists and legal scholars approach unanimity in the view that it is baffling that resale price ceilings are condemned in any but the most extraordinary circumstances. *Per se* condemnation is even more difficult to comprehend. *E.g.*, 8 P. AREEDA, ANTITRUST LAW ¶ 1634 (1989) ("maximum price limitations * * * should be presumptively lawful"); G.F. MATHEWSON & R.A. WINTER, COMPETITION POLICY AND VERTICAL EXCHANGE 14 (1985) (*per se* treatment of vertical price ceilings "ignor[es] completely all economic arguments"); R. BORK, THE ANTITRUST PARADOX 281-282 (1978; 1993 ed.) (criticizing "inflexible" prohibition despite lack of "anticonsumer effect"). As a former Antitrust Division chief economist observed, from an economic point of view, maximum resale price maintenance "is unambiguously beneficial both to consumers and society as a whole." Warren-Boulton, *Resale Price Maintenance Reexamined:* Monsanto *v.* Spray-Rite, in THE ANTITRUST REVOLUTION 371, 402 n.31 (J. Kwoka & L. White eds., 1989). See also, *e.g.*, Ippolito, *Resale Price Maintenance: Empirical Evidence From Litigation*, 34 J.L. & ECON. 263, 269 (1991) ("[M]aximum RPM allegations * * * have little economic support as antitrust charges."); Easterbrook, *Maximum Price Fixing*, 48 U. CHI. L. REV. 886, 890 n.20 (1981) ("Maximum resale price fixing has none of the potential anticompetitive consequences of horizontal maximum price fixing * * *."); *ARCO*, 495 U.S. at 343 n.13 (citing commentaries).

The decision in *Albrecht*, by contrast, reflects no attention at all to the most important factor bearing on whether maximum resale price maintenance should be condemned *per se*: the strong likelihood that "imposing a ceiling on resale prices may benefit consumers without any longer-term anticompetitive effects." 3 P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 734e, at 263 (1978). Rather than relying on any "demonstrable economic effect" (*GTE Sylvania*, 433 U.S. at 59) of price ceilings, the justifications for *per se* treatment advanced in

Albrecht reflect — in hindsight, and with respect — confused and self-contradictory analysis that mixes the effects of horizontal price fixing among competitors with the effects of vertical price restraints affecting a single brand, and mixes the potential effects of minimum resale price maintenance and with those of maximum resale price maintenance.

The Court in *Albrecht* attempted by mere say-so to equate maximum resale price maintenance with minimum resale price maintenance, declaring that (390 U.S. at 153):

> if the actual price charged under a maximum price is nearly always the fixed maximum price, which is increasingly likely as the maximum price approaches the actual cost of the dealer, the scheme tends to acquire all the attributes of an arrangement fixing minimum prices.

But the statement does not prove what it attempts to prove. Instead, it is tautological: the "minimum price" toward which price ceilings tend is "the actual cost of the dealer" — that is, the price in a perfectly competitive market.[3] That is scarcely an anticompetitive harm. To the contrary, "there is little or no

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[3] Judge Posner observed that, in defending against Justice Harlan's dissent, the *Albrecht* majority "demolishe[d] the intellectual foundations" of the rule against **minimum** resale price maintenance. R. POSNER, ANTITRUST LAW 158 (1976). The Court maintained that it was "beyond dispute that a substantial number of manufacturers formulate and enforce complicated plans to maintain resale prices because they deem them advantageous," and that in many situations manufacturers may "rightly regard minimum resale price maintenance to be in their interest." 390 U.S. at 151 n.7. By recognizing that minimum resale price maintenance was not characteristically the product of a retailer cartel, the Court took away the basis for assuming that the practice is almost always anticompetitive. Empirical evidence confirms that most uses of minimum resale price maintenance result from manufacturers' acting in their perceived self-interest; "collusion theories appear to be a relatively minor explanation for RPM-type practices overall." Ippolito, *Resale Price Maintenance: Empirical Evidence From Litigation*, 34 J.L. & ECON. 263, 293 (1991).

reason to fear that a vertical maximum might be an undetected minimum." 8 AREEDA, *supra*, ¶ 1637c, at 406. Vertical maxima do not facilitate, but rather combat, retailer cartels. See BORK, *supra*, at 452-453.[4]

The *Albrecht* Court also claimed that competitive harm might result from "substituting the perhaps erroneous judgment of a seller for the forces of the competitive market." 390 U.S. at 152. But that statement is puzzling. First, the antitrust laws have no mission to prevent "erroneous" benefits to consumers. Second, what *Albrecht* substitutes for the judgment of the seller is simply the "perhaps" equally "erroneous" judgment of the retailer who wants to raise price, reduce output, and harm consumers.[5] The Court provided no reason for preferring retailers' judgment that consumers should pay more to manufacturers' judgment that consumers should pay less. Indeed, because manufacturers are likely to take a broader perspective in both time and geography, their judgment is likely to be more

[4] In contrast to the present case, the maximum price agreement at issue in *Arizona* v. *Maricopa County Medical Society* raised concerns about disguised minimum price fixing because it was an explicit horizontal maximum price fixing agreement between "independent competing entrepreneurs" (457 U.S. at 357) and thus had the characteristics of a classic cartel. While agreeing that the *Maricopa County* agreement should be condemned, the United States urged the Court not to apply an unbending *per se* rule even to horizontal maximum price fixing, but rather to conduct a preliminary "quick look" analysis to determine whether the agreement was "essential to the operation of integrated productive activity." Brief for the United States as Amicus Curiae at 20, 22, *Arizona* v. *Maricopa County Medical Society*, No. 80-419. If so, the United States argued, the agreement should be analyzed under the rule of reason. *Id.* at 19-24.

[5] A third and equally powerful refutation of the *Albrecht* majority's reasoning — obvious in 1997 but understandably overlooked in the pre-deregulation era when *Albrecht* was decided — is that government regulation of pricing behavior is far more likely to produce an "erroneous" price than is the unconstrained operation of market forces. See S. BREYER, REGULATION AND ITS REFORM 58-59, 158-160, 184-187 (1982).

informed — and more oriented toward long-term benefits — than that of localized retailers. And the *Albrecht* Court's speculation (390 U.S. at 152-153) that manufacturers might persist in setting maximum prices "too low for the dealer to furnish services" needed or desired by consumers assumes the type of self-destructive behavior by manufacturers that "simply makes no economic sense" and renders the theory insupportable. See *Matsushita Electric Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

Much of the *Albrecht* Court's distaste for maximum resale price maintenance apparently derived from hostility toward a manufacturer's choice to "channel distribution through a few large or specifically advantaged dealers," particularly through the use of "exclusive territories" (as in *Albrecht* itself). 390 U.S. at 153. See also *id.* at 154 (citing *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)). But in *GTE Sylvania* and other cases, the Court since has overruled *Schwinn* and recognized that manufacturers by and large should be permitted to structure the distribution of their products as they see fit, whether through exclusive territories or otherwise.

Albrecht does not protect competitive markets, but substitutes judicial control for marketplace imperatives, largely in the name of protecting manufacturers from their own "perhaps erroneous judgment" (390 U.S. at 152). But that is not the business of the antitrust laws. As Justice Holmes observed, "the most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear"; a free actor in a free market generally will "know[ ] better" than courts "what will enable it to do the best business." *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373, 411, 412 (1911) (dissent). Allowing dealers to exploit market imperfections that are supported (if they are not, indeed, *created*) by the artifice of the *per se* prohibition on resale price ceilings does not defer to the market, but rather encourages localized market failures to the detriment of

consumers and manufacturers alike. See generally BREYER, *supra*, at 185-186.

B. It cannot be overemphasized that maximum resale price maintenance is a purely **vertical** restriction that affects the price only of single brands of products in markets that presumably are subject to interbrand competition. This Court has "recognized that the scope of *per se* illegality should be narrow in the context of vertical restraints," *Business Electronics*, 485 U.S. at 724, and with good reason: "[W]hen interbrand competition exists," as it does in most industries including automobile manufacturing, "it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." *GTE Sylvania*, 433 U.S. at 52 n.19. This Court long ago acknowledged that "[e]conomists have identified a number of ways in which manufacturers can use [vertical] restrictions to compete more effectively against other manufacturers." *Id.* at 54-55. As a result, "there is substantial scholarly and judicial authority supporting the[ ] economic utility" of vertical restrictions, and "little authority to the contrary." *Id.* at 57-58.

Resale price ceilings generally **help** consumers rather than harm them; lower prices are a goal of competition, not its enemy. "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels" — and predatory pricing is condemned regardless of the use of resale price ceilings — "they do not threaten competition." *ARCO*, 495 U.S. at 340. And **resale** price ceilings imposed by manufacturers that themselves compete on price and quality, as opposed to ceilings imposed by agreements among horizontal competitors, **cannot** injure competition, because they do not hinder any additional margin-cutting that may result from aggressive price competition among retailers — competition that is squarely in the economic interest of both manufacturers and consumers. See *GTE Sylvania*, 433 U.S. at 56. For those reasons, even vigorous proponents of *per se* condemnation of **minimum** resale price maintenance, including the current

chairman of the Federal Trade Commission, have recognized that **maximum** resale price maintenance "raises a host of different issues and probably should be treated under a rule of reason." Pitofsky, *In Defense of Discounters: The No-frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1490 n.17 (1983).

The *Albrecht* majority relied on a conception of the antitrust laws under which consumers were secondary if they mattered at all. That is wholly inconsistent with succeeding decisions that recognized that the Sherman Act was intended to be a "consumer welfare prescription." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 343 (1979). Moreover, the mistaken condemnation of practices like maximum resale price maintenance that reduce consumer prices is "especially costly." *Matsushita*, 475 U.S. at 594. The behavior condemned is a form of price cutting, and "cutting prices in order to increase business often is the very essence of competition." *Ibid.*

In the rare instance in which "anticompetitive effects are shown to result from particular vertical" maximum resale price restraints, "they can be adequately policed under the rule of reason." *GTE Sylvania*, 433 U.S. at 59.[6] Those few circum-

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[6] The "exceptions" to *per se* **legality** proposed by Professor Areeda (see 3 AREEDA & TURNER, *supra*, ¶ 734e, and 8 AREEDA, *supra*, ¶ 1638b) have little to do with maximum resale price maintenance in itself and much to do with independently illegal practices. An "exception" for "disguised" minimum price maintenance means only that any price restraints that function as price floors should be treated as price floors regardless of their form. An "exception" for the use of maximum resale prices in a predatory pricing scheme adds nothing to the existing condemnation of predatory pricing. And, although a vertical price restraint by a monopolist conceivably might fall afoul of the rule of reason, even in that circumstance it would be difficult to demonstrate that a maximum resale price harmed consumers in any way not fully achievable if the monopolist raised its wholesale price (causing retailers to reduce services) or integrated vertically. In any event, the Court need not today decide that maximum resale price maintenance is *per se* lawful; a holding that the rule

stances should not sustain a rule that forbids attainment of the benefits that would result from the great bulk of vertical price ceilings.

II. PER SE CONDEMNATION OF MAXIMUM RESALE PRICE MAINTENANCE IMPEDES OR DETERS SUBSTANTIAL PROCOMPETITIVE CONDUCT IN THE AUTOMOBILE INDUSTRY

The effects of the *per se* prohibition of maximum resale price maintenance reflect the very "unintended and undesirable rigidity in the law" that counsels against the application of *per se* rules. *GTE Sylvania*, 433 U.S. at 50 n.16. The experience of the automobile industry reveals a variety of circumstances in which the ability to impose resale price ceilings would advance manufacturers' ability to compete by lowering prices to consumers.

New automobiles are sold in the United States almost exclusively through networks of independent, franchised local dealers. Although automobile dealers do not have exclusive territories, several factors may contribute to give a dealer practical control over access to a brand of vehicles in a particular geographic area. The most obvious factor is geographic dispersion, resulting in large part from the efficiency-driven consolidation that has occurred at the dealership level over the past 50 years: less than half as many dealers sell three times as many vehicles as in 1949. *The 100 Year Almanac*, AUTOMOTIVE NEWS, April 24, 1996, at 112, 122, 128. Dealers in lower volume lines are, naturally, more distant from one another; some manufacturers separate their dealers by larger distances in order to attain the service levels associated with exclusive dealerships. In addition, state "dealer protection" statutes often give dealers some form of veto power over the location or relocation of a dealer in the same brand within a given geographic territory,

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of reason applies would suffice to require reversal in this case.

creating *de facto* exclusivity regardless of market efficiencies and manufacturer desires or policies.[7]

These conditions may impair or nullify intrabrand competition. Various temporary market conditions — ranging from consumer fashion to disparities in manufacturing and distribution costs for the nearest competing models for other brands — may combine to permit dealers, in some circumstances, to exercise a degree of pricing power.

Each new vehicle must display a sticker noting the manufacturer's suggested retail price ("MSRP") for the vehicle and any factory-installed optional equipment, as well as any transportation charges to the dealer. See 15 U.S.C. § 1232(f). But, as any recent car buyer is aware, the MSRP is generally just a starting point for bargaining between dealer and purchaser.

To the manufacturer, the difference between the retail and the wholesale price of its product is simply a cost of distribution, just as if the manufacturer paid employees to sell vehicles at retail. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 146 (1984). But the *per*

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[7] See, *e.g.*, BUREAU OF ECONOMICS STAFF REP. TO THE FEDERAL TRADE COMM'N, THE EFFECT OF STATE ENTRY REGULATION ON RETAIL AUTOMOBILE MARKETS (1986) ("STATE ENTRY REGULATION"). By 1984, "thirty-nine states [had] passed laws restricting the establishment of new automobile dealerships in the vicinity of present dealers selling cars of the same make." *Id.* at 1. See ABA ANTITRUST SECTION, FRANCHISE PROTECTION: LAWS AGAINST TERMINATION AND THE ESTABLISHMENT OF ADDITIONAL FRANCHISES 89 n.339 (Monograph No. 17, 1990) (listing 37 such statutes). Almost all states now restrict manufacturers' ability to induce intrabrand competition. *In Defense of Car Dealers*, BUS. WK., Apr. 18, 1996, at 17 (letter from John P. Peterson, President, National Automobile Dealers Ass'n) (49 state laws restrict manufacturers from "arbitrarily adding dealerships"; 40 states have "Relevant Market Area" provisions). The Bureau of Economics of the Federal Trade Commission concluded that these laws "raised car prices by a significant amount" (STATE ENTRY REGULATION, *supra*, at 8) that could cost consumers a total of "well over $3 billion per year" in 1985 dollars (*id.* at 108).

se prohibition on maximum resale price maintenance often confines the manufacturer's influence on the retail price to unenforceable suggestions. As Professor Areeda observed, "[U]nenforced price suggestions are unlikely to realize th[e] benefits" of price ceilings or other price maintenance arrangements. 8 AREEDA, *supra*, ¶ 1623c, at 269. If the *per se* ban is lifted, resale price ceilings are unlikely to become the norm in the automobile industry, but rather would provide an appropriate and effective device for manufacturers to respond to particular market conditions or particular types of dealer conduct.

A. The "Double Mark-Up" Inherent In Independent Retailing Aligns Manufacturers' Interests In Maximizing Output With Consumer Interests In Lower Retail Prices

1. Although manufacturers and dealers must work together in marketing new vehicles, their interests may diverge in particular market circumstances — particularly since participants at each level view the others' profits as costs to themselves. A manufacturer is likely to take a broader view of the economics of automobile distribution, based on far more comprehensive knowledge about conditions in increasingly global markets, resulting from continued efforts to sell vehicles through a network of hundreds or thousands of dealers. A dealer operating in a single locality has less access to information, and a narrower perspective as to the appropriate price. While a manufacturer's view of pricing must encompass both its own profit and sufficient dealer profits to ensure incentives to efficient distribution, the dealer logically views the manufacturer's profit as an undifferentiated element of input costs. That may lead the dealer to set a price that is higher than would maximize joint profits. MATHEWSON & WINTER, *supra*, at 13-14.

More fundamentally, a manufacturer subject to intense interbrand competition that depresses wholesale margins (as in

the automobile industry) will generally seek to maximize the sales volume of its product through efficient distribution with low intermediate markup: "For a given wholesale price," a manufacturer "wants the lowest retail price in order to sell more units." Easterbrook, *Vertical Arrangements*, 53 ANTITRUST L.J. at 147. If dealer markups rise above the level needed to provide the level of service that will attract customers, consumers may choose other makers' products, and the manufacturer will lose business to other brands with more efficient, lower cost distribution networks. When it comes to the amount of retailer margins, therefore, the manufacturer's self-interest in selling vehicles in volume usually coincides with consumers' self-interest in low prices and maximum choice among makes and models.

By contrast with the manufacturer's motivation to increase unit sales, a dealer may find it more profitable in the near term to reduce output (*i.e.*, yield some sales to other dealers or to consumer inaction) by increasing the margin on each vehicle. That motivation is especially powerful if the dealer can take advantage of temporary shortages in supply in the face of high demand.

For example, a manufacturer may want to stimulate demand with a $500 price decrease. Under current law, the manufacturer's principal recourse is to decrease the **wholesale** price in some form, without any guarantee that the reduction will be passed through to consumers and thus will increase sales volume. A dealer, by contrast, may find it more profitable to treat the $500 as profit and to sell the same number of vehicles at current demand levels with a far higher profit margin. That disposition to retain manufacturer discounts is exacerbated by low prevailing margins for dealers in a highly competitive interbrand market (which would be the normal stimulus for the manufacturer to reduce price).

2. Automobile manufacturers may need to increase sales in a particular line for urgent reasons other than immediate revenue generation. Automobiles are expensive to make, store,

and ship; dealer networks play integral roles in automobile manufacturers' inventory management and capacity utilization. Idle production capacity and unsold inventory are extremely expensive for manufacturers, but dealers are not necessarily as sensitive to which models need to be sold more quickly to resolve manufacturers' inventory or capacity concerns. Inefficiencies in inventory and production capacity lead to higher costs and thus to higher wholesale prices, ultimately harming consumers, dealers, and manufacturers alike.

Automobile manufacturers' views of the ideal retail price levels may diverge from those of dealers for another reason. Manufacturers depend on long-term customer loyalty to generate repeat purchases. An automobile manufacturer views a potential sale not just as a single transaction but as a foothold on remaining automobile purchases over the course of the buyer's lifetime. A customer who encounters too much difficulty in finding an acceptable price at one dealership may try a dealership with a different brand, and may forge a long-term relationship with another maker. And a buyer who becomes dissatisfied with the price **after** her purchase may switch brands rather than merely dealerships. Because dealers use manufacturers' brand names, dissatisfied customers are likely to blame the maker as much as the dealer, potentially costing the manufacturer several transactions in the future.

Some dealers — unlike manufacturers — may be more focused on the sale in front of them. Even the many dealers that cultivate repeat business rationally may value that factor somewhat less than manufacturers. Repeat purchases within the brand benefit the manufacturer no matter where they are made. By contrast, an individual dealer's ability to take advantage of customer loyalty to a particular brand of car may be undercut both by intrabrand competition from other dealers and by customers leaving the geographic area.

3. The various fluctuations in the supply of and demand for vehicles, combined with *de facto* exclusivity, may provide

an opportunistic automobile dealer with a chance to charge prices that increase the dealer's total margin despite exceeding the optimal market-clearing price.[8] Unless it has interbrand market power (which retailers rarely have, *Business Electronics*, 485 U.S. at 727 n.2), a dealer that trades volume for higher margins simply deflects some consumers away from the brand of vehicles they would have chosen first (and which the manufacturer would willingly sell at a transaction-effecting price).

Even if interbrand competition provides consumers with a measure of relief from these serious market imperfections, there certainly is no reason to prevent manufacturers from controlling the sale of their products to prevent the thwarting of consumer preferences and the muting of interbrand competition. The consumer who wants to purchase the "hottest" new sport-utility vehicle (or the most popular family car) and the manufacturer that wants to clear its inventory both suffer considerable harm from even localized, single-brand price distortions:

> The detriment to the consumer is obvious: higher prices. The detriment to the manufacturer is equally clear: fewer sales. The manufacturer thus serves both his own interests and those of consumers by * * * preventing dealers from profiting more than necessary for effective performance of the distribution function. This protects the public from price gouging.

8 AREEDA, *supra*, ¶ 1636a, at 395.

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[8] Conversely, dealers may not exploit competitive advantages in a way that benefits manufacturers (through maximum volume) and consumers (through lower prices). A manufacturer that has created a highly efficient distribution system would prefer that its dealers take advantage of that efficiency to price lower than rivals and maximize sales. But dealers facing less efficient interbrand rivals may opt to earn higher margins on fewer sales. The manufacturer's attempt to compete therefore may be stifled.

The economist's solution to the problem is simple: "a vertical price ceiling is normally welfare-optimal in the sense that all affected parties are better off if the practice is allowed." MATHEWSON & WINTER, *supra*, at 14. Once the maximum joint profit (the difference between the optimal price and the manufacturer's cost) is limited, the dealer is in a position to bargain for its appropriate share of that pie, which is smaller per unit but larger in the aggregate than the total profit that results from unrestrained dealer markups. *Id.* at 13-14.

But current law forbids this welfare-maximizing behavior. The *per se* prohibition on maximum resale price maintenance limits the effectiveness of manufacturers' efforts to ensure optimal pricing. Manufacturers have developed several less direct techniques of prompting spot price reductions or heading off spot increases in resale prices. We examine these techniques, and the limitations imposed by the *per se* rule, below.

B. The *Per Se* Prohibition On Maximum Resale Price Maintenance Hinders The Competitive Effect Of Dealer Incentives

Interbrand competition often requires manufacturers to attempt to stimulate retail demand in order to dispose of excess inventory or to use production capacity efficiently. These targeted price reductions, or dealer incentives, are an important method of competing against other brands.

For example, manufacturers may provide free or attractively priced optional equipment on a line of vehicles in an attempt to increase sales of a sluggish model, or as part of a regionwide promotion (*e.g.*, air conditioning at no extra charge on all vehicles sold in the Southeast). When the promotion applies to vehicles that have not been shipped to dealers, the MSRP can reflect the discount, providing some, albeit imperfect, assurance that most or all of the discount will reach consumers. To apply a similar promotion to vehicles that already are on dealer lots (with full-price MSRP stickers), a manufacturer rebates to the dealer its cost of the option. But,

under *Albrecht*, the manufacturer cannot require that the dealer agree to pass through the entire value of the option in the form of a retail price cut. As a result, a dealer may have the opportunity to split the cost of the option with the consumer by raising the vehicle price in another way (such as through an additional, more profitable option). To ensure that the advertised promotion is accurate and has the desired effect on the price to consumers, a manufacturer is confined to post-sale auditing and monitoring; attempts to enforce pass-throughs strictly can produce a dealer claim that the manufacturer is attempting to impose a resale price ceiling that is illegal under *Albrecht*.

Another common targeted price reduction is the old-model allowance or dealer cash program under which, late in the model year, dealers receive a small but significant percentage of the manufacturer's suggested retail price on each unit remaining in the dealer's inventory. These allowances are intended to induce dealers to lower retail prices by a corresponding amount, accelerating sales of the old models to make room for new models. But some dealers view these allowances as straightforward subsidies. The net result is to increase rather than to decrease dealer markups, on vehicles whose very retention in inventory demonstrates that demand is relatively low. The manufacturer's attempted response to market demand often disappears with scarcely a trace.

Automobile manufacturers can attempt to reduce the dealers' share of promotional funds by offering cash rebates directly to consumers purchasing certain models. But direct rebate programs entail substantial administrative expense, and dealers can capture much of the rebate amount simply by raising the net sale price of vehicles. The MSRP is not an entirely reliable measure of actual negotiated sales prices; most consumers know that fact and little more. And consumers often purchase according to the monthly payment amount (whether for a lease or a purchase) rather than the price, making dealer adjustments more difficult to detect by consumers and manufacturers alike.

Any attempt by a manufacturer to enforce a strict requirement that dealers pass through incentives to consumers risks condemnation as an excessive restraint on maximum resale prices under *Albrecht*. That is almost exactly what the petitioner in the present case did, setting a constant margin so that retail prices effectively had to trace changes in wholesale prices.[9] As a result, even those automobile manufacturers that would like to require that promotional funds be passed along to consumers can make only limited attempts to enforce compliance.[10]

C. The *Per Se* Prohibition On Maximum Resale Price Maintenance Hinders Manufacturers' Attempts To Protect Consumers From Dealer Opportunism

The reliance of automobile manufacturers on customer brand loyalty provides a strong motivation to discourage dealers from imposing excessive markups. It is difficult to cultivate brand loyalty in a customer who believes she has been overcharged. Although many dealers do not find it in their own interest to inflate retail margins, some dealers seize the occasional opportunity to do so. Because manufacturers cannot place upper limits on retail prices, however, they have little ability to ensure that consumers get the benefit of competitive

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[9] In our view, the resolution of the first question on which review was granted — whether a retailer subject to maximum resale price maintenance has standing to recover damages under the antitrust laws — depends on the resolution of the second question. If **all** resale price ceilings violate the antitrust laws, a theory supporting *per se* treatment presumably could supply a theory of antitrust injury encompassing retailers. Under the rule of reason, a retailer would have difficulty demonstrating antitrust injury based on his inability to charge higher prices to consumers.

[10] Manufacturer-sponsored parts and service promotions face the same risks of unenforceable pass-through. Similar difficulties sometimes arise in the context of manufacturer employee benefit programs under which employees are supposed to be able to purchase the manufacturer's vehicles at "cost."

wholesale prices or dealer incentives regardless of temporary, localized market conditions.

One common device that dealers use is the imposition of "additional dealer profit" (ADP) or "additional dealer markup" (ADM) on the price of a popular vehicle or "hot model." In addition to the MSRP sticker, dealers may print their own "second stickers," which often brazenly include a four-figure additional markup as a line item for "ADP" or "ADM." The MSRP sticker, traditionally the starting place for bargaining **down** a retail price, becomes instead the starting place for a substantial **increase** in price.

Manufacturers have no effective recourse to prevent second-stickering or ADP. They are equally powerless in the face of another familiar price-increasing device, the addition of more profitable "options" to a vehicle on the sales floor. The latter practice is not restricted to "hot models." Most car buyers are familiar with the attempts of dealers to add options to a vehicle that a buyer has selected but on which she has not yet closed a deal. Despite the potential harm of these practices to manufacturer interests in long-term customer brand loyalty, manufacturers may not be able to contract with dealers not to engage in these practices; doing so would be similar to the practice challenged in the present case, and would present a risk of liability under current law.

But consumers who are subjected to these practices by a minority of dealers eventually figure out that they have paid too much. And, despite the restrictions placed on manufacturers by *Albrecht*, consumers (who generally are unaware of legal niceties) hold automobile makers responsible for the fairness and efficiency of their distribution networks.

To be sure, the opportunity for imposing an additional markup may result only from the manufacturer's decision to accept a reduced margin on the wholesale price in the near term in the hope of securing greater consumer good will (and greater volume) in the long term. From the dealer's short-term perspec-

tive, the manufacturer may be leaving money on the table. But, even if the manufacturer's low wholesale price is properly attributed to its failure to appreciate the strength of demand for a particular model, the antitrust laws should not be concerned with — much less prohibit *per se* — the manufacturer's efforts to smooth the effects of temporary supply shortages by maintaining prices that are below the peak of the demand curve. To the contrary, any attempt to pass on benefits to consumers "erroneous[ly]" (*Albrecht*, 390 U.S. at 152) should be encouraged, not threatened with treble-damages lawsuits.

D. The *Per Se* Prohibition On Maximum Resale Price Maintenance Hinders Brand-Wide Price Advertising

Most advertising by automobile manufacturers appears in media of national, regional, or metropolitan scope. Yet manufacturers cannot engage in effective price advertising because they are unable to ensure that the first dealer visited after an ad runs will not exceed the advertised price. Rather, at most a manufacturer can advertise a "suggested price" that may be available only at "participating dealers."[11]

If there were no *per se* ban on maximum resale price maintenance, however, a manufacturer could advertise (and thus compete) on price in a far more realistic and reliable manner. A manufacturer's advertisement could state forthrightly that a vehicle's price would be "no more than X" — allowing dealers leeway to compete away some of the remaining margin and offer lower prices — without risking customer disappointment upon visiting "non-participating" dealers. Consumers would get more valuable information from such advertising and manufacturers could increase their credibility and thus enhance brand loyalty.

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[11] In current market conditions, the advertised figure is more likely to be a monthly lease or purchase payment than a total purchase price.

The recent efforts of some manufacturers to implement "one-price" or "no-haggle" pricing also would be bolstered if maximum resale price maintenance were no longer condemned *per se*. Some consumers clearly prefer firm pricing of new vehicles. Yet price advertising is difficult for the reasons outlined above, and manufacturers' one-price policies may be difficult to enforce if disputes arise; indeed, both federal and state antitrust authorities have raised questions about the practice, though they have not yet tried to stop it. *Feds' Pricing Probe May Tie Up Industry For Years*, AUTOMOTIVE NEWS, Oct. 17, 1994, at 1, 45.

E. The *Per Se* Prohibition Of Maximum Resale Price Maintenance Creates Uncompensated Inefficiencies

Resale price ceilings are the most efficient means of ensuring that dealer distribution costs do not swallow any efficiencies in manufacturing. Wholesale price reductions and promotional funds are imperfect competitive instruments when an intermediary can suppress their effect on retail prices.

The question for antitrust law is not whether there is anything inherently wrong with dealers seeking to maximize their profits by calibrating prices to the maximum consistent with a level of demand acceptable to the dealer. Rather, the question is whether a manufacturer that uses maximum resale price maintenance to place an upper limit the prices of its own products "always or almost always" injures competition — *i.e.*, consumers. Indisputably it does not.

To be sure, manufacturers have developed alternative means of stimulating price reductions to meet competitive circumstances, and some of those means have survived challenges in the courts. Many lower courts have been justifiably reluctant to give *Albrecht* an expansive reading, and accordingly have approved a variety of devices intended to impose resale price ceilings of some kind, finding for a variety of reasons that the net result of each device was not to "fix" prices vertically. *E.g.*, *AAA Liquors, Inc.* v. *Joseph E. Seagram & Sons, Inc.*, 705

F.2d 1203 (10th Cir. 1982) (finding no "coercion" by manufacturer), cert. denied, 461 U.S. 919 (1983); *Lewis Service Center, Inc.* v. *Mack Trucks, Inc.*, 714 F.2d 842 (8th Cir. 1983) (allowing *post hoc* wholesale price reduction limited to extent necessary to afford stated minimum profit on reduced retail price), cert. denied, 409 U.S. 1077 (1984); *FLM Collision Parts, Inc.* v. *Ford Motor Co.*, 543 F.2d 1019 (2d Cir. 1976) (allowing manufacturer to restrict discounts on wholesale price to sales to specified class of purchasers), cert. denied, 429 U.S. 1097 (1977).

But other courts suggest that they will find "vertical price-fixing" whenever a retailer is "in any way restricted in its freedom to set whatever prices it charged." *Discon, Inc.* v. *NYNEX Corp.*, 93 F.3d 1055, 1060 n.5 (2d Cir. 1996); *Pearl Brewing Co.* v. *Anheuser-Busch, Inc.*, 339 F. Supp. 945 (S.D. Tex. 1972). And the indirect means of limiting resale prices are less certain than the enforcement of resale price ceilings. Moreover, even unsuccessful antitrust challenges often proceed into expensive discovery, diverting resources that would be better used in business improvements or lower prices. The very real threat of antitrust litigation in response to any practice that resembles maximum resale price maintenance is a strong deterrent. See Ippolito, *Resale Price Maintenance: Empirical Evidence From Litigation*, 34 J.L. & ECON. 263, 269, 293 (1991). As one scholar recently noted (*id.* at 293):

> the long-standing concern that the per se standard prohibiting RPM deters too many efficiency uses of RPM may actually understate the potential severity of the problem. The stricter de facto liability standard for RPM acts to discourage RPM-like activities beyond those that the courts would find in violation of the per se standard.

See also Baumol & Ordover, *Use of Antitrust to Subvert Competition*, 28 J.L. & ECON. 247, 254 (1985); Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 6 (1984).

This legal uncertainty hinders activity that would heighten interbrand competition and lower consumer prices. Heightened competition and lowered prices — brought about by market forces rather than government edict — are properly the goals of the antitrust laws, not the objects of *per se* illegality.

III. *STARE DECISIS* DOES NOT WARRANT RETAINING *PER SE* CONDEMNATION OF RESALE PRICE MAINTENANCE

The *per se* condemnation of maximum resale price maintenance has received the type of skeptical response from scholars and lower courts that supported the overruling of the *per se* ban on exclusive territories in *GTE Sylvania*, 433 U.S. at 47-48. As we pointed out above, the "great weight of scholarly opinion has been critical," and "a number of the federal courts confronted with analogous vertical restrictions have sought to limit [*Albrecht*'s] reach." *Id.* at 47-48 & nn.13-14. Although the efforts of the courts may be "a tribute to judicial ingenuity" in the pursuit of economic rationality and efficiency, *id.* at 48 n.14, a sensible system of jurisprudence should not force the courts to whirl in doctrinal epicycles in order to reconcile insupportable rules with rational results.

It is absolutely vital to an efficient economy that this Court venture "to second-guess the wisdom of [its] *per se* rules." *ARCO*, 495 U.S. at 359 (Stevens, J., dissenting). "[D]ifferent sorts of agreements" may amount to restraints of trade "in varying times and circumstances." *Business Electronics*, 485 U.S. at 731. "It would make no sense," therefore, to leave the "line of *per se* illegality * * * forever fixed" while economic understanding, and markets themselves, change. *Id.* at 732. "If condemnation *per se* depends on a conclusion that almost all examples of some practice are deleterious, then discoveries of possible benefits lead to new legal rules." Easterbrook, *Limits*, 63 TEX. L. REV. at 10. *Per se* prohibitions on business conduct have enormous costs, not only from the activity prohibited but from legal activity deterred by the risk of burdensome litigation

and treble-damages judgments. See Baumol & Ordover, *supra*, 28 J.L. & ECON. at 254. *Per se* antitrust rules cannot depend for their persistence on decades or even centuries of history: what matters here is "the effect of the antitrust laws upon vertical distributional restraints in the American economy **today**." *GTE Sylvania*, 433 U.S. at 53 n.21 (quoting *Schwinn*, 388 U.S. at 392 (Stewart, J., dissenting)) (emphasis added).

The Court recognizes each Term that a change is necessary in an established legal doctrine, often in contexts that are less subject to material transformations in understanding and circumstances than are the legal proscriptions on business behavior. *See, e.g.*, Eskridge, *Overruling Statutory Precedents*, 76 GEO. L.J. 1361 (1988); D. O'BRIEN, SUPREME COURT WATCH –1993, at 11-13. The common law character of the Sherman Act makes the Court's correction all the more necessary, and dilutes the force of *stare decisis*. See Eskridge, *supra*, 76 GEO. L.J. at 1377-1381; Easterbrook, *Vertical Arrangements*, *supra*, 53 ANTITRUST L.J. at 136-140. Indeed, Congress recognized the "changing content of the term 'restraint of trade'* * * at the time the Sherman Act was enacted," *Business Electronics*, 485 U.S. at 731, and has "h[eld] the text of the Sherman Act inviolate" in the face of this Court's changing antitrust doctrines. Easterbrook, *Vertical Arrangements*, 53 ANTITRUST L.J. at 137. As Justice Stevens has pointed out, Congress fully "expect[ed] the federal courts to interpret [the Sherman Act] by developing legal rules on a case-by-case basis," so that "the doctrine of stare decisis d[oes] not preclude th[is] Court from overruling" those of its prior antitrust decisions that have not withstood the test of time and intensive analysis. *Guardians Ass'n* v. *Civil Service Comm'n of New York*, 463 U.S. 582, 641 n.12 (1983) (dissent).

"Just as what was once lawful may be proscribed under new approaches, so what was once condemned may be restored to legitimacy as judges reassess their earlier acts." Easterbrook, *Vertical Arrangements*, *supra*, 53 ANTITRUST L.J. at 139. A reassessment is appropriate here: rule-of-reason treatment for

maximum resale price maintenance is both "intrinsically sounder" than *per se* condemnation and "verified by experience" of the pro-consumer effects of holding down prices. *GTE Sylvania*, 433 U.S. at 58 n.30. Even cursory consideration of the market effects of maximum resale price maintenance makes it clear that a *per se* prohibition of the practice can only harm consumers. Accordingly, *Albrecht* should be overruled, and maximum resale price maintenance returned to the sphere of business practices that are subject to the "prevailing standard of analysis" (*GTE Sylvania*, 433 U.S. at 49): the rule of reason.

CONCLUSION

For the foregoing reasons, the judgment should be reversed.

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IN THE
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OCTOBER TERM, 1996

STATE OIL COMPANY,
Petitioner,
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BARKAT U. KHAN and KHAN & ASSOCIATES,
an Illinois Corporation,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF AMICUS CURIAE OF NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

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BRIEF AMICUS CURIAE OF NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

The National Association of Manufacturers ("NAM") is the nation's oldest and largest broad-based industrial trade association. NAM's 14,000 member companies and subsidiaries—including approximately 10,000 small manufacturers—are in every state and collectively produce 85 percent of U.S. manufactured goods. The majority of these members distribute their products through independent wholesalers and retailers. Hence, NAM's membership is keenly interested in any antitrust case that bears materially on distributive practices. *State Oil Co. v. Khan*, No. 96-871 (Sup. Ct., *cert. granted*, Feb. 18, 1997) is of particular concern because that case presents this Court with a watershed opportunity to restore to legitimacy the

procompetitive practice of vertical maximum resale price setting by overruling *Albrecht v. Herald Company* ("*Albrecht*"), 390 U.S. 145 (1968) which held that such price fixing was *per se* illegal.[1] Acting on that interest, NAM, pursuant to Supreme Court Rule 37.3, sought and obtained the written consent of the parties to its participation as an *amicus* so that it might argue, in support of the petitioner, that the redeeming virtues of vertical maximum resale price setting make *per se* treatment of that practice inappropriate and mandate instead for a traditional rule of reason analysis.[2] The requisite consents to NAM's participation have been filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

State Oil presents this Court with a unique opportunity to re-examine *Albrecht* and supplant that case's *per se* approach to maximum resale price fixing with a rule of reason analysis. The *Albrecht* Court fell into error in reasoning by analogy. That Court determined that if *minimum* resale price fixing was per se unlawful then, by a parity of reasoning, so should *maximum* resale price setting. But, of course, supplier-sponsored maximum price fixing is not inimical to competition nor is it perniciously

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[1] A practice is said to be *per se* unlawful when it is so inimical to competition that, in place of a consideration of that arrangements' merits to see if it is "reasonable" under the antitrust laws, the practice is instead conclusively presumed to be "unreasonable", and, hence, unlawful. In that event, proof of the arrangement alone suffices to prove the Sherman Act violation. See, *Arizona v. Maricopa County Med. Society*, 457 U.S. 332, 342-44 (1982); *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

[2] Instead of presuming illegality, the rule of reason calls for a broad ranging fact-based economic inquiry regarding the market affects of a challenged practice to determine if it is anticompetitive, i.e., "unreasonable" under the antitrust laws, or whether there are procompetitive effects that justify the practice, rendering it "reasonable" and, hence, lawful under the Sherman Act. See, *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918).

anticompetitive. On the contrary, that practice, employed in appropriate circumstances, can produce important distributional efficiencies and demonstrable consumer benefits. Because vertical maximum resale price fixing has such redeeming market virtues and social utility, it should be assayed by the rule of reason and not, as now, conclusively presumed unlawful.

ARGUMENT

A. *State Oil* Presents This Court With A Unique Opportunity To Re-examine *Albrecht* And To Supplant With A Traditional Rule Of Reason Analysis That Earlier Case's *Per Se* Approach To Maximum Resale Price Fixing

The *State Oil* case is the perfect vehicle for re-evaluating the *Albrecht* case's use of a *per se* rule to outlaw supplier-originated maximum resale price setting. *State Oil* is virtually indistinguishable factually and economically from *Albrecht*. See, Opinion of the Court of Appeals ("Appellate Op") Petitioner's Appendix ("Pet. App".) at 10a.

Albrecht concerned a newspaper publisher's practice of imposing a ceiling on the price at which it would permit its exclusive dealers to resell the *Herald* newspaper in their respectively assigned territories. The *State Oil* case involved much the same practice, although the affected commodity was gasoline rather than newspapers. In *Albrecht*, the *Herald* publisher decreed specified maximum prices; State Oil instead set a suggested retail price for each of its brands of gas and then sold that gasoline to a gas station operator for 3.25 cents under that suggested price. As contractually, any revenue in excess of the specified 3.25 cent margin had to be rebated, State Oil's suggested price, just like the *Herald*'s ceiling price, was actually a maximum retail sale price.

A reconsideration of *Albrecht* now, in the context of *State Oil*, is not merely appropriate but also decidedly timely. It has now been nearly thirty years since the *Albrecht* decision. In the intervening years, this Court has had a significant exposure to the procompetitive

virtues of vertical non-price restraints and supplier sponsored maximum resale price setting. *See, e.g., Atlantic Richfield Co. v. USA Petroleum Co.*, ("*Arco*"), 495 U.S. 328, 333 (1990) (Maximum resale price setting "does not cause a competitor antitrust injury unless it results in predatory pricing"; maximum price fixing has the effect of lowering prices to consumers); *Business Elec. Corp. Sharp Elecs. Corp.*, 485 U.S. 717, 724 (1988) (No vertically imposed restraint should be judged *per se* illegal unless it involves the actual setting of prices); and, *Continental TV, Inc. v. GTE Sylvania, Inc.* ("*Sylvania*"), 433 U.S. 36, 50 (1977) (Exclusive dealer territories analyzed under the rule of reason; "departure from the rule of reason standard must be based upon demonstrable economic effect").[8]

In fact, it was a review of these and other recent vertical restraint precedents of this Court that moved Chief Judge Posner, writing for the panel below, to remark that this Court's holdings have effectively "doomed" *Albrecht* by rendering that case's theoretical basis for use of a *per se* rule not merely "infirm" but "increasingly wobbly" and "moth-eaten". Appellate Op. Pet. App. at 9a.

Notwithstanding his attack on *Albrecht*, Judge Posner declared that he and the *State Oil* appellate panel were nonetheless constrained by *stare decisis* to adhere to *Albrecht*'s *per se* rule in judging the antitrust legality of State Oil's setting of maximum resale price ceilings. *See, Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiensgesellschaft*, 19 F.3d 745, 752-54 (1st Cir. 1994). Judge Posner explained that it lay only with this Court to over-

[8] So too, economic learning has progressed sufficiently in the period since *Albrecht* was decided such that through case exposure the judiciary has now gleaned sufficient knowledge of "industrial organization, cartel theory and dominant firm behavior to identify those conditions that must be satisfied before [concluding] that use of a particular vertical arrangement in a particular context is likely to cause social harm". See, Baxter, The Viability of Vertical Restraints Doctrine, 75 CAL. L. REV. 933, 947 (1987).

rule *Albrecht*; something that, given the right opportunity he said he fully expected this Court to do. *Id.* at 9a. This is that right opportunity.

B. The *Albrecht* Court Wrongly And Unnecessarily Outlawed Vertical Maximum Resale Price Setting

The *Albrecht* Court never made an assessment of the purpose and effect of supplier-originated maximum resale price fixing. The Court ignored any possible differences that might exist between vertical *maximum* resale price setting and *minimum* resale price maintenance, observing only that both practices equally usurped dealer pricing prerogatives. The Court instead focused on the fact that resale price maintenance had long been recognized as perniciously anticompetitive. *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). Reasoning by analogy, the Court concluded that maximum price fixing also should be banned as *per se* unlawful.

Maximum resale price setting differs, of course, in method, purpose and effect from minimum price fixing. Hence, the analogy that the *Albrecht* Court sought to draw was incorrect, a fact the dissent in *Albrecht* suggested by pointing out that the setting of a price ceiling is a natural procompetitive incident to a scheme of territorial exclusivity. 390 U.S. at 169.

C. Vertical Maximum Resale Price Fixing In Appropriate Contexts Actually Yields Efficiencies And Consumer Benefits

Manufacturer-set maximum resale prices produce real economic benefits. Thus, for example, in those rare instances where a dealer might have market power or, more likely, economic leverage, a supplier-imposed price ceiling can serve the valuable function of restraining a dealer's temptation to extract an artificially high price for the sub-

ject goods. Absent such restraint, artificially high dealer prices frustrate any attempt by a supplier to pass along any manufacturing efficiencies to the public in the form of reduced, more competitive prices. Instead, the dealer's artificially high price reduces demand for the manufacturer's product (effectively reducing output). And, at the same time, the public is forced to pay more.

It was this very fact pattern that was presented in *Albrecht*. The *Herald*'s dealers had a form of market power or economic leverage rooted in their exclusive territories and the fact that there was but one evening paper. The *Herald* wanted maximum circulation and so sought to put a ceiling on the price that could be charged by any of its dealers. When one of those dealers violated the ceiling and threatened to reduce output (in this instance, to reduce circulation), he was replaced with a more compliant dealer. The same economic benefits of a ceiling price discussed above were of course sought by the *Herald* in *Albrecht*. But, the *Albrecht* Court ignored these redeeming off-setting procompetitive virtues.

Another example of the social utility of maximum resale price fixing is illustrated in markets where there is a less expensive private label alternative to a full priced branded product; *e.g.*, over-the-counter drugs, cereal, soda, and health & beauty aids. Absent a manufacturer's right to set a price ceiling on its branded products, a dealer could inflate the retail price of the branded product, thereby, providing an umbrella for the sale of its private label goods at higher prices than might otherwise prevail for such unadvertised and unbranded items.

The result, once again, of this unchecked dealer activity is a reduction in the demand for the branded product and sale of the private label at an artificially high price. As a consequence, competition is suppressed in not one but two markets: The one for the branded product and the other for sale of the private label. The immediate effect of this is to increase the branded manufacturer's

cost of distribution while at the same time depressing its sales volume.[4] The consequences of this dealer behavior are significant: There is a loss of efficiency in distribution, reduction of the manufacturer's output (another way of saying lost sales and less effective interbrand competition), and diminished ability of the manufacturer to absorb fixed costs. As for consumers, they pay more for both the branded and the private label product.

Because of *Albrecht*, manufacturers for the last 30 years have not been able to use maximum resale price fixing to combat the distribution problems created by perfectly rational but nonetheless anticompetitive dealer behavior. Manufacturers have instead had to resort to promotional rebates and other forms of incentives to ensure that prices are reduced and interbrand competition spurred and intensified. But, dealers can often frustrate these strategies simply by keeping the rebate or not passing along any or all of the price reduction. As a result, the manufacturer's price reduction or incentive program fails to meet its promotional objectives. Instead, the dealers' profit margin is increased and the manufacturer gets none or few of the expected sales for its effort. So too, the consumer is denied the intended price benefits of the manufacturer's marketing program.

Manufacturer-set maximum resale price fixing obviates these problems while also securing consumers more competitive markets and, thus, lower prices. Supplier-sponsored price ceilings are, in fact, the most efficient means of insuring that efficiencies in manufacture, wholesale price reductions or promotional incentives are passed on to consumers.

There is little or no adverse effect on competition arising from the use of this practice. Maximum price setting is, in fact, largely antitrust benign. Judicious maximum

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[4] Distribution cost goes up because, by definition, a manufacturer's cost of distribution is the difference between the wholesale price to dealers and the retail price of the product.

resale price fixing threatens neither inevitable nor significant anticompetitive consequence. As this Court noted in *Arco*: Vertical maximum price fixing "does not cause a competitor antitrust injury unless it results in predatory pricing". *Id.* at 335 n.5, and 339-40. *See also, Indiana Grocery, Inc. v. Super Valu Stores, Inc.*, 864 F.2d 1409, 1416-1420 (7th Cir. 1989) (fixed non-predatory prices do not cause injury to competitors). Even dealers that have a maximum resale price imposed on them are not likely to be hurt because, if the practice performs in accordance with expectations, the dealer's sales will increase —at the expense of its competitors.

D. As Vertical Maximum Resale Price Fixing Has Undeniable Social Utility It Therefore Should Be Judged By The Rule Of Reason And Not Presumed Unlawful

In *Sylvania*, this Court explained that the rule of reason should be the presumptive test by which conduct is judged under the antitrust laws; a *per se* rule only should be invoked for practices that, in the overwhelming majority of instances, demonstrably threaten serious and pronounced anticompetitive consequences. *Sylvania*, 433 U.S. at 50 (1977). Put another way, a practice will not be conclusively presumed to be "unreasonable" and therefore *per se* illegal unless it is shown to have a "pernicious effect on competition and [to] lack [. . .] any redeeming virtue". *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

That is surely not the case with State Oil's maximum price setting, any more than it was true in *Albrecht* of the *Herald's* ceiling pricing. The *Herald*'s use of maximum resale price fixing as a distributional tool was never shown to augur severe anticompetitive market dislocations. And, there is nothing to suggest that State Oil's practice is anymore inimical to competition. To the contrary, it is plain that the *Herald*'s vertical price fixing and that of State Oil had legitimate business purposes and threatened no serious effect on competition, let alone a pernicious one.

In sum, maximum resale price fixing demonstrates "redeeming market virtues" that, under the standards of the antitrust laws, does not merit being treated as presumptively illegal. It is time to abandon *Albrecht*'s *per se* rule so that manufacturers, in proper contexts, may take advantage of the efficiencies of price ceilings as a distribution tool.

CONCLUSION

This Court is presented with few occasions when it can correct an error, dispel doctrinal disarray and supply an impetus to the intellectual development of an area of the law. But that is precisely what has happened here. Judge Posner has invited this Court to expressly overrule *Albrecht* and its *per se* approach to vertical maximum resale price fixing and substitute in its place a full fledged rule of reason inquiry. This is an invitation that this Court can and should accept.

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Joint Amicus Curiae Brief
In Support of Respondent
of
National Coalition of Petroleum Retailers
Gasoline and Auto Service Dealers of America
Automotive Trades Organization of California

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QUESTIONS ADDRESSED

Amici will address both questions presented in the petition:

(1) Whether the Court should overrule the decision in Albrecht v. The Herald Company holding that vertical maximum price fixing is *per se* illegal under Section 1 of the Sherman Act ?

(2) Whether the Court should adhere to its position that a dealer whose maximum prices are fixed by the supplier has suffered antitrust injury ?

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INTEREST of THE AMICI

The National Coalition of Petroleum Retailers, Gasoline and Auto Service Dealers of America, and Automotive Trade Organizations of California are trade associations that represent the interests of our nation's 50,000 independent retailers before legislative tribunals and the judiciary. Most of the retailers we represent own or operate a single location.

NCPR and its co-amici have long been concerned with proper interpretation of the antitrust laws, as those laws are a two-edged sword for our members. For example, members of AUTO-Cal were named as antitrust co-conspirators in USA Petroleum v. Atlantic Richfield, 495 U.S. 328 (1990).

In this case, we file our brief (with consent of the parties) solidly on the side of the Respondent, and urge that the verdict be affirmed. Our members view this case as Armageddon, a grave threat to the most precious right the Sherman Act guarantees: the right to fail or succeed in business based upon one's own merits (or lack thereof). The maximum margin fixing scheme in this case forecloses any meaningful opportunity to compete on the merits.

This case represents a classic battle between economic theory and economic reality. We expect our brief to be substantially different from others, as we shall focus on "economic reality."

An important piece of economic reality is that our members have invested **billions** of dollars in petroleum marketing franchises and facilities, in reliance upon the decisions of this Court that they will be truly independent businessmen and women, as opposed to glorified clerks, whose prime function is to insulate our suppliers from environmental and other liabilities.

> "Dealers, like Simpson, are independent businessmen; and they have all or most of the indicia of entrepreneurs, except for price fixing . . . *Practically the only power they have to be wholly independent businessmen, whose service depends on their own initiative and enterprise, is taken from them by the proviso that they must sell their gasoline at prices fixed by Union Oil* . . . The evil of this resale price maintenance program, like that of the requirements contracts held illegal by Standard Oil Co. v. United States, supra, is its *inexorable potentiality for and even certainty in destroying competition in retail sales of gasoline* by these nominal "consignees" who are in reality small struggling competitors seeking retail gas customers. Simpson v. Union Oil Co. , 377 U.S. 13, 21(1964).

Simpson and other decisions have been relied upon in numerous legislative debates. For example, though the Petroleum Marketing Practices Act, 15 U.S.C. 2801-2806 was passed "in response to the possibility that the destruction of the independent segment of the retail sector of the oil industry would *eliminate the only level of independent pricing in the oil industry*." Note, Judicial Interpretation of Title I of the Petroleum Marketing Practices Act: Conflict and Diversity, 32

Emory L.J. 273 at 281, as a result of the Court's "unwavering decisions", there was no need to attempt to codify the *per se* rule in the PMPA debate.

This reliance interest strongly counsels against overturning the long line of precedent condemning naked price restraints such as this one.

Petitioner suggests that if the Court relaxes the *per se* rule, failure to adhere to a reasonable price term could be a basis for termination under the "reasonable and material" provision of the PMPA (15 U.S.C. 2802(b)(2)(A)). This is significant, because it shows that the inevitable consequence of changing the rules of the game will be to generate a flood of litigation under the PMPA and the Sherman Act, on the issue of whether a fixed price was "reasonable". The Court has steadfastly refused to go down this path, and our members have little desire to set sail on this "sea of doubt."

There simply is no compelling legal or economic reason for the Court to open the door of the Pandora's Box of maximum price or margin fixing.

SUMMARY of ARGUMENT and ECONOMIC ANALYSIS

As the "Magna Carta of free enterprise," the Sherman Act, was intended to guarantee the right to fail or succeed in business based upon one's own merits (or lack thereof). *The foreclosure of a meaningful opportunity to compete on the merits engendered by the maximum margin fixing scheme in this case is touchstone of illegality in our view.*

The economic reality is that ***a 3.2 cent gross margin on gasoline barely pays the utility bill at a modern, well lit, 24 hour gas station, much less allow the recoupment of the other costs of doing business, particularly those imposed by the supplier, or the provision of services desired by consumers.*** *The most efficient retailer in the world cannot survive on the maximum margin at issue in this case*.

The Court is being asked to disregard the principal of *stare decisis* and the reliance interest created by its decisions, based upon the theoretical benefits of non-price vertical restraints, in a case where there is *no chance* that these benefits can be realized, and consumer welfare enhanced.

> *Vertical nonprice restraints only accomplish the benefits identified in GTE Sylvania because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services.*" Business Electronics v. Sharp Electronics, 485 U.S. 717,726, (1988). That is not the case here.

Industry experts have stated, oil distributors have acknowledged, and Congressional reports have found that independent dealers are the most efficient marketers of petroleum products. It costs an independent dealer anywhere from 7 to 12 cents per gallon to market a gallon of gasoline, whereas oil company operated stations incur costs of 10-14 cents per gallon, largely because business owners perform better than employees. See, U.S. Senate Judiciary Committee Report #102-450 (1992).

Our members have discovered that the most effective way to market gasoline is to work off what is called "WAM" or

weighted average margin."WAM" is determined simply by multiplying the gross margin on each product by the percentage of each grade of gasoline being sold (usually 60-70% regular, 10-15 % midgrade, 20-30% premium) and dividing by 3.

Regular gasoline is usually sold at a gross margin of 0 to 3 cents; and depending on the region of the country, can often be found below cost. Gross margins on midgrade typically run from 6-12 cents. Gross margin on premium can run from 11-18 cents, which is why the "Wild Wednesday" or "Thrifty Thursday" promotions a reader may be familiar with invariably involve premium gasoline.

Careful analysis of the real world economics of retailing, and the facts of the case show that the anticompetitive effects that concerned the Albrecht court are present.

First, the maximum gross margin set was far too low to allow Khan, or any other retailer for that matter, to survive, much less allow the provision of desired services.

Vertical maximum price fixing can also have the effect of insulating a supplier's wholesale pricing practices from the competition enhancing effects of the retail market. This is a particular problem in the gasoline marketing industry because, virtually every retailer is locked into an exclusive dealing contract that contains a "minimum volume" provision, and has "sunk costs" that foreclose the argument that a dealer will "simply stop carrying the price-fixed product."

Next, a maximum price fixing scheme can be a very effective method by which a supplier may channel distribution to

favored parties, or to facilitate vertical integration. Restrictions on such actions contained in the Petroleum Marketing Practices Act, 15 U.S.C. 2801-2806, as well as numerous state laws, can be circumvented by this, or other pricing schemes that may economically evict the dealer. In Texaco v. Hasbrouck , 496 U.S. 505(1990) the Court noted that:

> "an indirect price discount to competitors may be used to force directly supplied franchisees out of the market, and so to circumvent federal restrictions upon the termination of franchise agreements." 496 U.S.505 n.23.

Oil companies are currently converting many markets to distributor supply and selling marketing premises as well. Economic eviction of the existing dealer, particularly dealers in prime locations, allow the supplier to dispense with the PMPA requirement that the dealer be given the right to match any offer to purchase the marketing premises. 15 U.S.C. 2802(b)(3)(D). In other cases, the large distributor may want the stations to be "dealer free," so they can take the retail profit for themselves. Senate Report #102-450 @ 7.

One result of such schemes is to create wealth transfers from motorists to relatively inefficient oil distributors, in violation of what some argue is the primary goal of the Sherman Act. Phoenix and Tucson are two examples of cities that once had relatively low gas prices; but now have high prices, due in part to the channeling of distribution to less efficient operations.

These two concerns identified in Albrecht manifest themselves in a practice we have labeled, for want of a better

term, "predatory costing". In the retail gasoline industry; the supplier sets the major costs of doing business : product cost, real estate or "occupancy" costs, credit terms, and maintenance charges. A naked maximum price restraint can facilitate "risk-free predation": that is the "predatory" campaign imposes no costs upon the predator that will have to be recouped later on.

Moreover, the maximum price fixing scheme effectively insulates the supplier's wholesale prices from the competitive forces of the retail market, particularly where the retailer is "locked in" by exclusive dealing contracts, or switching costs.

A classic predator incurs costs; on the hope that greater damage will be inflicted on the target, and recoupment of those costs, and excess profits, will follow the target's exit from the market.

In the "predatory costing" scenario, the supplier raises the costs of doing business, such as higher wholesale price facilitated by the maximum price scheme, as well as other costs of doing business for the retailer, until the retailer gives up.

Why do this? The economic motive is that "we want the retail margin too"; the legal motive is to evade the PMPA or other laws that may interfere with the suppliers' desires.

In sum, the superior marketing efficiencies of independent retailers can be rendered null and void by a supplier imposing costs upon the retailers, and then using a maximum margin fix to deny the retailer the opportunity to recoup those costs.

Allocative inefficiencies and the denial of the opportunity to stand or fall on one's own business merit results. Where a maximum price is set too low to allow the restrained party to recoup the costs imposed upon it by the supplier, *per se* treatment is particularly appropriate.

The third anticompetitive effect identified in Albrecht, the threat that the maximum price may become the minimum price, has occurred in this case.

The most popular grade of gasoline, regular unleaded, self serve, is frequently sold near, or even below cost, by the vast majority of gasoline retailers today. The margin fix placed a floor under this price, with the net result being that consumers at Khan's station, particularly brand loyal users of the Union 76 proprietary credit card, were paying a premium for regular gas.

When the station went into receivership; the restraint was lifted, and the efficient pricing mechanism used by most independent retailers implemented, output,(volume sold at the station) rose substantially.

It is worth noting that Simpson arose out of Simpson's refusal to follow Union's pricing dictates, and he was terminated for selling regular gasoline for 27.9 cpg, as opposed to the 29.9 price called for by Union. The bottom line is that economic reality supports retention of the *per se* rule.

We would be more than happy to fight this battle on the field defined by the broad, remedial, statutory language, the legislative history, discussed *infra*, (which clearly condemns all forms of price fixing); and the historical context of the Act.

The language of statute clearly condemns this naked price restraint. The historical materials strongly support this position. In a very useful, but often overlooked, commentary on the history of the Sherman Act, Rush H. Limbaugh, Sr., father of today's famous commentator, provides powerful historical evidence that price fixing of any type was intended to be prohibited by the Sherman Act. Limbaugh, Historical Origins of Anti-Trust Legislation, 18 Mo. L.Rev. 215(1953).

The legislative history, including statements by Senator Sherman, clearly condemns schemes such as that before the Court. There is no reason to chart a course different from that mapped out by decision in United States v. Socony-Vacuum Oil Co., 310 U.S. 150(1940), where it was held:

> .... a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se." 340 U.S. at 213. "*For over forty years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful per se under the Sherman Act.*"Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference. Congress has not left with us the determination of whether or not particular price-fixing

> schemes are wise or unwise, healthy or destructive. If such a shift is to be made, it must be done by the Congress. Certainly Congress has not left us with any such choice. Id., at 221-222.

Some 42 years later, in a 1982 maximum price fixing case, the Court stated that:

> "We have not wavered in our enforcement of the per se rule against price fixing. Arizona v. Maricopa County Medical Society, 457 U.S. 332, 343(1982).

We address *infra*, the fatally flawed argument that the Court in Continental T.V. v. GTE Sylvania ,433 U.S. 36(1978); *sub silento* overruled Albrecht despite its holding that:

> " The per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy."433 U.S.36, 51 n.18.

The best example of theory versus economic reality is represented by the notion that suppliers need the ability to set maximum prices in order to protect the public against widespread abuse of "dealer market power".

> "Retail market power is rare, because of the usual presence of interbrand competition and other dealers, see Continental T. V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 54 (1977), and it should therefore *not be assumed* but rather must be proved." Business Electronics v. Sharp Electronics, 485 U.S. 717 (1988).

At no point do Petitioner or any of its Amici suggest that the presumption of unreasonableness created by the *per se* rule should be rebuttable in an authentic case of dealer market power. This leads us to question whether or not the real agenda here is to argue for rule of reason treatment today; in order to set up tomorrow's argument of *per se legality* based upon the suppliers' lack of market power. These arguments can be simply summed up :

"We must give the ultimate power to the giant in order to avoid being harmed by the gnat."

GTE Sylvania holds that it would be a mistake to condemn non-price vertical restraints in a manner "divorced from market considerations." It would also be a mistake to approve vertical price restraints in this manner. The finding of antitrust liability should be affirmed based upon the economic reality and market conditions of this case.

Even if one views Albrecht as an aberration, as opposed to an incremental step in the development of this area of the law, it is no more of an aberration than baseball's antitrust exemption. Like the baseball antitrust exemption, the Court's unbroken string of price fixing cases has generated a substantial reliance interest that requires that precedent be honored and the debate returned to the halls of Congress.

Petitioner's supporting Amici represent the best funded and best connected lobbying organizations in Washington. If the Albrecht rule has truly had the real world anticompetitive effects attributed to it, we doubtlessly would have seen a vigorous legislative effort to overrule it. The lack of such an effort is

telling evidence that the theory does not match the reality.

If the Court is inclined to modify the *per se* rule, we would urge the Court to only go so far as to treat the rule as a presumption that can be rebutted only in an authentic case of dealer market power. Alternatively, we believe that the presumption should remain irrebuttable in certain cases, such as where the maximum price is "predatory". Under either formulation we propose, the decision below should be affirmed.

Economic reality reveals that Court is being asked to impose a cure that is worse than the disease. While Albrecht may have been on the other end of the factual spectrum from this case, the criticism of that decision paints with far too broad a brush.

Albrecht was a logical extension of the prior decisions of this Court; which manifest an unyielding hostility to price fixing, a hostility that is consistent with, indeed, compelled by, the language, legislative history and purposes of the Sherman Act.

ARGUMENT

I. VERTICAL PRICE FIXING HAS BEEN SPECIFICALLY CONDEMNED BY CONGRESS

Section 1 of the Sherman Act of 1890 literally prohibits every agreement "in restraint of trade." In United States v. Joint Traffic Assn., 171 U.S. 505 (1898), the Court recognized that Congress could not have intended a literal interpretation of the word "every".

Thus, since Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911), most restraints have been analyzed under the so-called "rule of reason". Nevertheless, the Court in

Standard Oil recognized that inquiry under its rule of reason ended once a price-fixing agreement was proved, for there was "a conclusive presumption which brought [such agreements] within the statute." 221 U.S. at 65.

The broad language and historical context of the statute, as well as its legislative history mandate continuing *per se* treatment of all naked price restraints, including the vertical maximum margin fixing. We turn first to the historical materials.

Limbaugh demonstrates that consideration of the history of the era when a piece of legislation is"definitely and securely established as a part of our law.", and is necessary because:

"These statutes were originally passed by Congress and the legislatures of several of the states prior to the adoption of the modern technique for drafting legislation. They have no preambulatory statement of legislative policy. They have no definition of terms. They are not made up of paragraphs with numerical subdivisions *precisely providing what exact conduct they forbid*, or what practices are exempt from their operations." Limbaugh, Historical Origins of Anti-Trust Legislation, 18 Mo. L.Rev. 215, 217 (1953).

Additionally judges who were "far removed from the era which first produced the legislation" needed to be familiar with the historical evidence. The historical evidence shows that the restraint at issue here was intended to be rendered illegal by the Sherman Act.

Among the "appalling evils" that led to the passage of the Sherman Act was the loss of the opportunity of small dealers to compete on the merits:

> "Independent business enterprises, small manufacturers and lesser industries, were limited and restricted by rigid credit requirements, discriminated against by more powerful competitors, ***handicapped by arbitrary price- fixing which deprived them of profits***, intimidated by threats of boycotting, required to pay freight rates on their own commodities, and to contribute to the rates paid by their larger competitors, . . . driven to the brink of economic ruin, were in large numbers absorbed by the feigned benevolence of more highly organized and more pitilessly powerful competitors". Id. at 236,237.
>
> "Farmers, traders, laborers, individual business proprietors, and small business enterprises were frequently rendered helpless and often disappeared in the fierce wars of the leviathons of the new order for then control of the railroads, industries and finance of the country. Victims of these battles for supremacy came to realize that the economic laws of supply and demand, competition in business and freedom in trade, on which the economic foundation of the nation were laid, were no longer effective,; that the ideals of equality of opportunity, individual freedom, self-reliance, and personal initiative were losing their preeminence." Id.@240,241.

Among the policies and conduct identified by Limbaugh as causing these problems was "secret agreements fixing prices, dividing territory, and granting advantages to the favored, and exacting exorbitant payments from competitors . . . ". He further noted that the impetus for the legislation was a protest and revolt

against combinations that could restrict production, ***fix prices***, crush opposition, favor the view to the detriment of the money,. and against *every business and every practice which tended to deprive the public of the advantages of free competition.*"Id.

The legislative history also shows that Congress intended to ban restraints such as vertical price fixing.

The manager of the legislation on the floor of the House, Congressman Culbertson, specifically cited vertical price fixing as a practice the Sherman Act was intended to outlaw. See; 21 Cong. Rec. 4089-90 (51st Cong. 1890).

Senator Sherman specifically condemned price fixing:

> "If anything is wrong, this is wrong. If we will not endure a king as a political power we should not endure a king over the production, transportation and sale of any of the necessaries of life. If we would not submit to an emperor we should not submit to an autocrat of trade, with power to prevent competition and to fix the price of any commodity," 21 Cong.Rec. 2457 (51st Cong.1890).

Interestingly, supporters of the legislation singled out oil company price fixing as a target of the legislation:

> "Some may say that the trusts have made products cheaper, have reduced prices; but if the price of oil, for instance, were reduced to 1 cent a barrel, it would not right the wrong done to the people of this country by the trusts,"See, 21 Cong. Rec. 4100 (51st Cong. 1890) (Remarks of Cong. Mason.)

It is significant that the opponents of the Sherman Act opponents of the legislation argued against its enactment on the basis that it would ban certain"efficient" practices such as formation of partnerships and corporations (See, 21 Cong. Rec. 2605 (51st Cong. 1890),(remarks of Sen.Stewart), and would overrule the decision in Fowler v. Park 131 U.S. 88 (1889) (upholding vertically imposed territorial divisions) and claimed that the interpretation that the Act bans vertical price fixing was inconsistent with that and other decisions. 21 Cong. Rec. 5953-56 (51st Cong. 1890).

The condemnation of price fixing was explicit, unequivocal, and must be respected. See, United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 218(1940). Cf. Jefferson Parish v. Hyde 466 U.S. 2 ,11(1985).

II. THE FLAWED CASE AGAINST THE PER SE RULE

A. The Language of the Statute and Its Legislative History

Petitioner and its amici cite, but do not discuss the language of the statute. They discuss no legislative history in support of their position, because none exists.

B. The Cases: GTE Sylvania Did Not Overrule Albrecht

A number of critics rely on the erroneous proposition that Albrecht is founded upon U.S. v. Schwinn, and thus was fatally undercut by Continental T.V. v. GTE Sylvania.433 U.S. 36(1978), even though ***Schwinn was not even cited in any of the briefs***, and the Sylvania Court held that :

> " The per se illegality of price restrictions has been established firmly for many years and involves

significantly different questions of analysis and policy." Id. @51 n.18.

Indeed it does, for price restrictions have been repeatedly singled out by Congress, as the paradigmatic example of prohibited conduct under the Sherman Act.

A central thesis of this argument is GTE Sylvania, specifically "*The Myth of Footnote 21*" renders irrelevant any concern that small business have an opportunity to compete on the merits, and that the antitrust laws protect the "freedom of traders", even though these concerns animated the debate over the Sherman Act, and have been repeatedly cited in price fixing cases dating back to Dr. Miles.

Footnote 21 was the Court's response to one of the 9th Circuit dissenting opinions, which in the view of the Court appeared to convert these legitimate concerns of the antitrust laws into a talisman that would invalidate all vertical restraints " totally divorced from market considerations."

The market considerations in this case dictate a finding of illegality, and the facts of the case simply do not fit the mold of the theories being advanced to save this restraint.

We stress that we are not saying that mere "limitation of dealer freedom" causes an antitrust violation - any restraint limits freedom by its very nature. Naked price restraints simply destroy the ability of a business, particularly small business, to even have ***a shot at competing on the merits.*** It is this *foreclosure of meaningful competitive opportunity* that is forbidden.

The argument that GTE Sylvania puts to bed any antitrust

concern over the right and ability of small businesses' to compete is as great an excess as those the Sylvania court wished to correct.

The fundamental premise underlying GTE Sylvania was that antitrust pendulum had swung too far to the left; and that over deterrence was depriving consumers of potentially welfare enhancing conduct. The Court today is being asked to swing the pendulum not only too far to the right, but off the scale entirely. Sylvania was not intended to overturn 88 years of authority solidly opposed to theoretical premise being advanced in order to legitimize price fixing today. The rationale that overkill is to be avoided supports the striking down of the restraint at issue.

C. The Myths of Dealer Market Power and Inefficient Distribution

The picture some paint of dealers possessing, and exercising a Herculean amount of market power, is like Hercules, himself, a myth.

The example of exclusive territories in the newspaper industry, and the dubious assumption that newspapers are a "natural monopoly", are heavily cited. We are in an era where consumers are beginning to enjoy the fruits of the fall of other so-called "natural monopolies"in the telecommunications and electricity industries. Moreover, this example is open to serious questions in this Information Age, where one can pull the major stories from the newspapers off of the Internet.

In the gasoline marketing industry, some have pointed at "turnpike stations" as an example of dealer market power. First, higher prices at these stations are often due to payments that must

be made to the turnpike authority, or other governmental entity. Next, travelers have the ability to plan where they are going to buy gasoline, and may avoid such stations altogether, or decide that the value of their time exceeds any extra cost of gasoline.

As to Albrecht itself, our review of the record before the Court, reveals that Mr. Albrecht *charged the suggested price for those customers who prepaid their monthly bill*, and only charged a slightly higher price to those customers who he was effectively extending credit to. The impression that Mr. Albrecht was gouging consumers appears to be overstated.

In a nutshell, the Court is being asked to impose a cure that is worse than the disease. In Business Electronics, the Court stated that the fear of dealer market power did not justify a rule of per se illegality. 485 U.S. 717,727 n.2.

It is equally certain that this fear does not justify changing the rules of game that have been relied upon by our members and legislators alike for nearly a century.

If the Court remains troubled by the *result* in Albrecht, we suggest that allowing the presumption of unreasonableness to be rebutted in a case presenting authentic dealer market power, is a far superior approach to "throwing out the baby with the bath."

It has been argued that the ***per se rule*** should be abandoned because it forces suppliers to resort to "inefficient" indirect methods of influencing retail prices. This argument does not withstand analysis.

We have already shown that the major components of

gasoline prices are already in the hands of suppliers. In addition, there is hardly a gasoline retailer in the country who does not receive some degree of price counseling from his or her supplier.

Moreover, suppliers have a number of incentive programs that are conditioned upon the retailers meeting certain volume goals, including rebates on fuel purchases and rents.

Perhaps some Amici prefer a "stick" as opposed to a "carrot"", but even then, there are ample "sticks" in a suppliers arsenal. For example, virtually every supply contract has a minimum gallonage provision that a dealer must make good faith efforts to comply with, or risk termination under the Petroleum Marketing Practices Act.

In our convenience stores, many items come with preprinted prices that effectively serve as a maximum price. Those few cases where such prices are exceeded generally occur in remote or high cost areas where the goods or services would not otherwise be provided.

It is most telling that Petitioner and its Amici can summon no empirical data in support of this inefficiency argument, much less meet the heavy burden that would be needed for the Court to even consider rewriting the rules of the retail game.

D. Other Flaws in the Economic Analysis

Other arguments have been made based upon assumptions that do not square with the economic reality. First, the argument is made that if the price set is too low "dealers will not be willing to continue carrying the product". See, Brief for

American Petroleum Institute at 17. This is nice in theory, but the real world does not work that way. The fact is that retailers generally find themselves locked in by reason of contract provisions, and the investments they have made in their franchises.

Exclusive dealing contracts are now almost universal in the gasoline marketing industry, and a retailer confronted with a maximum price fix cannot switch brands, or *even obtain the exact same gasoline at a lower wholesale price from another authorized distributor.*

Gasoline suppliers also have "market power" over their dealers because of the substantial investments the retailers make. in the franchise and the marketing facility known as "sunk costs'.

The major components of sunk costs are (1) the initial cost of acquiring the franchise, which can run hundreds of thousands of dollars, with the facts this case very much at the low end of the scale; (2) cost of acquisition of the real estate; (3) cost of facility upgrade and maintenance and (4) cost of inventory and labor.

These "sunk costs" often consist of the life savings of the men and women who operate today's gasoline stations.

> *". . . The run of the mill service station dealer is a man of limited means who has for him, a sizable investment in his station. Much of that investment is in the goodwill attached to the gasoline he sells, the TBA he stocks, and the location of the station where sells these products. While it is true that is expensive for Shell to switch dealers, it is far more expensive, in relative terms for a*

> *dealer to lose his station."* Shell Oil Co.v. F.T.C., 360 F.2d 470, 487 (5th Cir. 1966), cert.denied, 385 U.S. 1002 (1966).

In "When Do Franchisors Have Market Power" 65 Antitrust L.J.150, 153 (1996); Professor Grimes points out that where a supplier has power of its dealers, maximum price fixing causes allocative inefficiencies, such as distortions in terms of investment dollars allocated to a franchise; the creation of distorted incentives for the goods and services of the supplier, and a supplier insulating itself from forces that would dictate phasing out a given product. We would add that the ability to insulate the wholesale price from the competition enhancing forces of the retail market adds to these inefficiencies.

It is no answer to say that "suppliers have no incentive to set a price that is too low, because in so doing they decrease their own profits." Brief of API at 17. Again, reality and theory are at odds with each other. A maximum price fixing scheme increases oil company profits because the supplier effectively insulates its wholesale price from competitive forces present in the retail market. Most maximum price fixing schemes are premised on the idea that retail demand will either increase or remain the same. Additionally, the increased profit at "wholesale" can easily offset any fall in retail demand, and retail demand is further influenced by the fact that a retailer who fails to sell the minimum volume specified in his or her contract risks termination under the PMPA.

The assertion that the suppliers have "the incentive to set socially optimum restraints" is also misleading. We have seen that a minimum price fixing scheme can be a tool to channel

distribution to favored dealers or to increase vertical integration, and thus circumvent other statutes in addition to the Sherman Act

The desire of an oil distributor to take the "retail profit too" leads them to target the prime locations operated by our members. The only way they can obtain them is for the retailer to give them grounds for termination under the PMPA, or for the company to economically evict the dealer.

Judge Posner observed that the scheme at issue provided "an equally effective sanction to franchise termination", and this Court has already noted the potential of pricing schemes to circumvent the PMPA in Hasbrouck, 496 U.S. 505 n.23.

It is readily apparent that the theory-based attacks on Albrecht are not firmly grounded in reality.

III. ALTERNATIVE APPROACHES

A. The Rebuttable Presumption Approach

Any concern that the Albrecht rule may be too inflexible, and may be causing overdeterence can be addressed by allowing the presumption of unreasonableness to be rebutted in certain cases, as opposed to jettisoning the *per se* rule entirely. This approach is consistent with recent decisions of the Court, and has been endorsed by leading commentators.

> "Courts should view the per se and rule of reason methods primarily as a single method of analysis, regarding them as evidentiary rules establishing presumptions and burdens of proof rather than hard and fast substantive rules to be rigidly applied, The Court has,

> in fact, sometimes followed this better method of analysis." Flynn, The Is and Oughts of Vertical Restraints After Monsanto, 71 Cornell L.Rev.1095, 1143. (1986)

In NCAA v. Board of Regents of Univ. Of Okla., 468 U.S. 85 (1984) the Court noted that :

" there is often no bright line separating per se from Rule of Reason analysis." Id. @ n.26.

. The per se rule is a presumption of unreasonableness based on "business certainty and litigation efficiency."Arizona v. Maricopa County Medical Society, 457 U.S., at 344.

If the Court jettisons the *per se* rule, businesses would lose well-defined rules, and litigation would surely increase. The rebuttable presumption approach would mitigate some of those effects.

As noted, *supra*, we would urge the Court to only go so far as to allow the presumption to be rebutted only in an authentic case of dealer market power. Such power can be found only where (1) the supplier creates an entry barrier through an exclusive territory, (2) there is no substitute product consumers can readily turn to and (3) the exclusive territory and other entry barriers exist that make it unlikely that substitute products would find their way into the market.

As an alternative, the presumption should remain irrebuttable where (1) the maximum price is "predatory" in the sense that is set at a level that does not allow the retailer a meaningful opportunity to compete on the merits; or the

opportunity to recoup its costs of doing business (2) where the margin is such that desired services cannot be provided or (3) where the retailer is suffering from a "lock in"; which can occur due to an exclusive dealing contract, high switching costs or imperfect information.

B. The Rule of Reason Approach

Amici are adamant in their position that Rule of Reason treatment is not appropriate for naked price restraints such as that at issue. The Court has steadfastly refused to be drawn into the debate over whether a fixed price is reasonable. If petitioner's arguments are suggested, that will change, as discussed, *supra*.

At a minimum, price restraints should be subjected to the "quick look" Rule of Reason, where the absence of market power by the party promulgating the restraint, does not necessarily make the restraint "reasonable".

> "*As a matter of law, the absence of proof of market power does not justify a naked restriction on price or output.* To the contrary, when there is an agreement not to compete in terms of price or output, "no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement." Professional Engineers, 435 U.S., at 692 . . . Thus the plan is inconsistent with the Sherman Act's command that price and supply be responsive to consumer preference. We have never required proof of market power in such a case. This naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis." NCAA v. Board of Regents of

Univ. Of Okla.,468 U.S. 85, at 110, 111 (1984).

Despite protests to the contrary, the fact is that Petitioner's supporting Amici are looking to create a rule of ***de facto per se legality*** of vertical maximum price fixing. The reason is that once subject to the rule of reason, they will argue that they lack market power, therefore any restraint, including naked price restraints, that they impose upon their retailers, raise no antitrust concerns.

One recent example is found in the case of Ajir v. Exxon, No-93-20830(C.D.Cal. 1996). In that case, San Francisco Bay area Exxon retailers challenged revisions to their franchise agreements that would prevent them from purchasing Exxon gasoline from Exxon distributors, and would force them to purchase all of their Exxon gasoline directly from Exxon, at significantly higher prices.

Exxon was awarded summary judgment on the basis that it did not have market power, as it only had an 11% market share in the Bay Area. Thus, an exclusive dealing contract, that had the effect of substantially increasing consumer prices was held to be off the antitrust radar screen.

Rule of reason cases have largely turned into an exercise of attempting to define a market in which the promulgator of the restraint has less than a 50% market share, and thus lacks market power, therefore the restraint is *per se* reasonable. Cases such as Ajir, Queen City Pizza v. Domino's Pizza, 922 F.Supp 638 (E.D.Pa. 1996) , and Judge Posner's observation that under the Rule of Reason, Khan loses, exemplify this trend.

We believe that even under the Rule of Reason, Khan should win, and the lower courts need to hear this message.

V. The Antitrust Injury Claim Is Without Merit

In our view , Petitioners' antitrust injury argument is a thinly veiled effort to achieve a backdoor repeal of the *per se* rule; based largely upon the decision of the 7th Circuit in Jack Walters and Sons Corp. v. Morton Building Inc, 737 F.2d. 698 (7th Cir.1984). It is significant to note that:

> "Even consumers would not be able to bring actions under the rule established in Judge Posner's opinion in Jack Walter & Sons Corp. v. Morton Building ." Hovenkamp, Chicago and Its Alternatives,1986 Duke L.J.1014, 1025-26 (footnote omitted).

This statement is equally true if Petitioner's formulation of the antitrust injury rule is adopted. Essentially, their argument is that vertical maximum price fixing is never anticompetitive.

We have shown, through the lens of economic reality, that the anticompetitive effects identified in Albrecht, as well as others have in fact occurred in this case, therefore, Khan's injuries "flow from that which makes the challenged conduct unlawful."

In USA Petroleum v. Atlantic Richfield, 495 U.S. 328 (1990), the Court noted that :

> "In Albrecht we held such an agreement per se unlawful because of its potential effects on dealers and consumers . . . . . The "existence of an identifiable class of persons whose self-interest would

> normally motivate them to vindicate the public interest in antitrust enforcement diminishes the justification for allowing a more remote party . . . to perform the office of a private attorney general. Id.@ 337. If such a scheme causes the anticompetitive consequences detailed in Albrecht, (and it has in this case) consumers and *the manufacturers' own dealers may bring suit . . .*"

After noting that misapplication of the antitrust injury requirement could preclude suits by consumers; Professor Hovencamp states:

> ....I cannot escape the conclusion that Judge Posner--growing impatient with Congress's or the Supreme Court's refusal to overrule Albrecht--has decided to undertake that task on his own. Members of the Chicago School have visions, as do most of us, of the kinds of things that should obtain in a perfect world. *The per se rule against resale price maintenance is definitely not among them. That fact justifies arguments, both theoretical and political, but it does not justify taking the matter into one's own hands, no matter how certain we may be that we are right.*" Hovenkamp, Chicago and Its Alternatives,1986 Duke L.J.1014, 1025-26 (footnote omitted).

The Court should again reject the invitation to use the antitrust injury device as a backdoor method of substituting its economic judgment for that of Congress', even if a majority can be convinced that Congress was wrong.

CONCLUSION

The antitrust laws were designed to guarantee the right of retailers to compete on the merits, free of naked restraints on the central nervous system of retail prices, not to codify abuses by powerful suppliers.

The touchstone of illegality in this case is the foreclosure of any meaningful opportunity to succeed or fail on one's own merits. Congress fully intended to prohibit restraints of this type.

When bringing the legislation before the Senate, Senator Sherman remarked that:

> "The popular mind is agitated with problems that may disturb the social order, and among them all none is more threatening than the inequality of condition, of wealth, *of opportunity* that has grown within a single generation out of the concentration of capital into vast combinations to control production and trade and to break down competition." 21 Cong. Rec. 2460 (51st Cong., 1890).

It seems to us that the contemporary "popular mind" would be seriously agitated if the Court were to cede control over retail prices to the Exxon's and Mobil's on the theory that these industrial behemoths do not have market power; yet a "mom and pop" Exxon retailer does.

In the final analysis, the argument for overruling Albrecht boils down to the notion that "*we must give power to the giant to avoid being harmed by the gnat*".

If the Court should decide a retreat from Albrecht is appropriate, that retreat should only go so far as to allow a defendant to rebut the presumption of unreasonableness in certain cases such as that one where at least a colorable argument of dealer market power can be raised, and there is a substantial possibility of consumers actually receiving some of the benefits of efficiencies achievable through a a non-price vertical restraint.

This is not a case about who can generate the most law review articles or ivory tower economic theories supporting their position. It is about real men and women, who have invested billions of dollars and a heck of a lot of sweat equity into small businesses , thinking that their success, or lack of it, was going to largely be determined by their skill and initiative.

All our people want is a chance to compete. Congress gave our people that right. After nearly a century, the Court is being asked to take this right away.

The verdict for Khan is compelled by the plain language of the statute, its legislative history and historical context, and the real world economics of the case. The verdict should be affirmed.

Respectfully submitted,

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Dated: May 5, 1997

CERTIFICATION UNDER RULE 37.6

I hereby certify that no counsel for any party authored this brief in whole or in part; and that no party made any financial contribution to the preparation of this brief.

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CERTIFICATE of SERVICE

I hereby certify that on the 5th day of May, 1997, I served copies of this Amicus Curaie Brief, via first class U.S. Mail , postage prepaid, upon the following:

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF AMICUS CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

The Association of the Bar of the City of New York (the "Association") is an organization composed of nearly 21,000 lawyers. While most members of the Association practice in the tri-state New York Metropolitan area, there are members from almost every state and from over fifty foreign countries. The Association's Committee on Antitrust and Trade Regulation has participated in shaping antitrust and trade regulation policy for decades, and its members include practitioners who represent both plaintiffs and defendants, as well as academicians.

The Association has a particular interest in the issue presented in this case—the appropriate test for judging maximum resale price maintenance. It first began studying this issue eleven years ago, issuing a formal report. Based on that study, and the work that it has performed since, the Association is concerned that clarification is needed in this area of the law and believes that this brief will provide substantial assistance to the Court in performing its analysis.

Respectfully submitted,

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The Association has a particular interest in the issue presented in this case—the appropriate test for judging maximum resale price maintenance. It first began studying this issue eleven years ago, issuing a formal report. Based on that study, and the work that it has performed since, the Association is concerned that clarification is needed in this area of the law and believes that this brief will provide substantial assistance to the Court in performing its analysis.

SUMMARY OF ARGUMENT

The *per se* rule against maximum resale price maintenance was announced in 1968 in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), at a time when *all* resale restraints were subject to *per se* illegality under *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). The *Schwinn* decision was overruled in 1977 in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), but *Albrecht* remained the law.

In *Sylvania* the Court was not called upon to reexamine maximum resale price maintenance, but it recognized generally that "[p]er se rules of illegality are appropriate only when they relate to conduct that is manifestly anti-competitive," *id.* at 49-50, and that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing." *Id.* at 58-59. Maximum resale price maintenance should not be considered such "manifestly anticompetitive conduct," since it generally has the effect of lowering prices to consumers, and has greater potential to intensify interbrand competition than to diminish it. Although it does have the potential to inhibit non-price competition at the dealer level, such impact can be effectively weighed in a rule of reason inquiry to determine whether, on balance, a particular arrangement is procompetitive or anticompetitive. Such an approach would be preferable to the continued blanket imposition of *per se* illegality.

ARGUMENT

The Association began studying the phenomenon of maximum resale price maintenance eleven years ago, and believes that the results of its extended examination should prove valuable to the Court in conducting its analysis of the issues raised in this case. In 1986, the Association issued a report in which it endeavored to present a balanced evaluation of the existing standard. That report remains timely and informative today, and is reprinted as an appendix to this brief. The present discussion undertakes to pinpoint exactly what is and is not presented on this review, and to examine further the wisdom of the *per se* rule that currently is applied to maximum resale price maintenance.

PARAMETERS OF THE ISSUE ON APPEAL

At issue in this case is the appropriate treatment of a pricing concession provided by a supplier to a dealer on the condition that the dealer not charge its own customers more than an agreed maximum resale price. The broader issue presented is the appropriate treatment of all caps placed by suppliers on the resale prices of their dealers—so-called "maximum resale price maintenance."

Origins of the *Per Se* Rule. In 1911, in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), this Court held resale price maintenance to be *per se* illegal. In 1967, in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), the Court went further and indicated that *all* resale restraints should be treated as unlawful *per se*. A year later, with all resale restraints still being subject to *per se* illegality, the Court took what then amounted to a relatively small step by

specifically holding in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), that maximum resale price maintenance—by which a supplier and dealer agree that the dealer will not charge more than a specified resale price—should be included in the catalogue of *per se* unlawful resale restraints.

Abridgement of the *Per Se* Rule. In 1977, *Schwinn* was overruled in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). The Court held that "[p]er se rules of illegality are appropriate only when they relate to conduct that is manifestly anti-competitive," *id.* at 49-50, and that "departure from the rule of reason standard must be based upon demonstrable economic effect rather than—as in *Schwinn*—upon formalistic line drawing." *Id.* at 58-59. *Albrecht,* however, remained the law, as the Court in *Sylvania* was not called upon to reach the issue of maximum resale price maintenance.

In the years following *Albrecht,* a succession of courts invented a variety of approaches for sparing maximum resale price maintenance from the ax of *per se* illegality. In case after case the courts found that there was a lack of causation, agreement or injury, and few defendants were ever found liable for the offense of maximum resale price maintenance.[1] The

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[1] *Northwest Publications, Inc. v. Crumb*, 752 F.2d 473 (9th Cir. 1985) (no causation because short-term termination clauses would have prevented dealers from raising their prices in any event); *Jack Walters & Sons Corp. v. Morton Buildings, Inc.*, 737 F.2d 698 (7th Cir.), *cert. denied*, 469 U.S. 1018 (1984) (persuasion and policing during promotion not illegal; also, no antitrust injury); *Curry v. Steve's Franchise Co.*, 1985 WL 6277 (D. Mass. 1985) (not enough coercion to establish

most notable exception was *Caribe BMW, Inc. v. Bayerische Motoren Werke AG,* 19 F.3d 745 (1st Cir. 1994), where the First Circuit held that the plaintiff had adequately alleged injury by showing that it had lost profits as a result of a maximum resale pricing agreement that inhibited it from selling to potential customers who would have preferred better service at higher prices.[2]

Price Assistance Programs. At the same time, numerous cases were decided concerning so-called "price assistance programs," or "pass throughs" whereby a supplier offered discounted pricing to its dealer on the condition that the dealer pass that discount along to the dealer's own customers. Typically, the supplier in these cases wanted to enable its dealers to lower their own prices in order to capture greater sales volume, while preventing the dealers from simply "pocketing" the discount and continuing to charge their customers the same resale prices as before.

These programs had suffered a serious setback in 1972, in the middle of the *Schwinn* era, when a district court in Texas decided that it amounted to *per se* unlawful resale price maintenance for a supplier to provide a discount to a dealer on the condition that the dealer pass that discount along to its customers. *Pearl Brewing Co. v. Anheuser-Busch, Inc.,* 339

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agreement); *Martindell v. News Group Publications, Inc.*, 621 F. Supp. 672 (E.D.N.Y. 1985) (no coercion proved).

2 *See also Blanton v. Mobil Oil*, 721 F.2d 1207 (9th Cir. 1983), *cert. denied*, 105 S.Ct. 1874 (1985); *Arnott v. American Oil Co.*, 609 F.2d 873 (8th Cir. 1979), *cert. denied*, 446 U.S. 918 (1980).

F.Supp. 945 (S.D. Tex. 1972). Relying largely on this Court's decisions in *Schwinn* and *Albrecht,* the court there held that "conditioning a price reduction on the acquiescence or cooperation of the recipient to reduce its price can only be viewed as imposing restrictions on the reseller's freedom of decision, and, as such, is an unlawful price fixing combination".[3] *Id.* at 955.

As soon as *Schwinn* was overruled and *Sylvania* announced that the rule of reason should be the standard for judging vertical restraints other than resale price maintenance, the *Pearl Brewing* principle was rejected in a series of court of appeals decisions in various circuits.[4] These cases held that there is no resale price maintenance when a supplier offers a discount to a dealer on the condition that the dealer pass that discount along to its customers, either dollar-for-dollar or together with additional discounts that the dealer itself provides.

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3 Interestingly, *Pearl Brewing* was instituted by a competitor, and today would likely be thrown out for lack of antitrust injury under *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990).

4 *See Lattice Semiconductor Corp. v. Interface Electronic Corp.*, 37 F.3d 1505 (9th Cir. 1994); *Jack Walters & Sons Corp. v. Morton Bldgs., Inc.*, 737 F.2d 698 (7th Cir.), *cert. denied*, 469 U.S. 1018 (1984); *Lewis Service Ctr., Inc. v. Mack Trucks, Inc.*, 714 F.2d 842 (8th Cir. 1983), *cert. denied*, 467 U.S. 1226 (1984); *AAA Liquors, Inc. v. Joseph E. Seagram and Sons, Inc.*, 705 F.2d 1203 (10th Cir. 1982), *cert. denied*, 461 U.S. 919 (1983); *Bryant Heating and Air Conditioning Corp., Inc. v. Carrier Corp.*, 597 F. Supp. 1045 (S.D. Fla. 1984).

The reasoning behind these decisions was that since there was no agreement on the preexisting price that the dealer charged prior to the discount, there should be no price fixing in requiring the dealer to lower that price by the amount of the discount.

In 1988 this Court decided *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), clarifying the law further by holding that *per se* unlawful resale price maintenance is limited to instances in which a supplier and its dealer agree that the dealer will resell at a specific price or price level. Other agreements between suppliers and dealers regarding resale prices would be judged under the rule of reason, permitting the fact finder to evaluate all of the procompetitive and anticompetitive effects of the agreement. The *Sharp* decision thereby bolstered the line of "pass through" cases that had overruled *Pearl Brewing*, because there was no agreement in those cases on what the dealers' ultimate resale prices would be, and the lower courts continued to hold that price assistance programs were not *per se* unlawful.[5]

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[5] *See Lattice Semiconductor Corp. v. Interface Electronic Corp.*, 37 F.3d 1505 (9th Cir. 1994). Furthermore, subsequent to *Sharp*, courts have found that a number of other types of agreements between suppliers and dealers concerning the dealers' resale prices did *not* constitute *per se* unlawful resale price maintenance because they too did not include an agreement on a specific price or price level. For example, one case held that it is not *per se* unlawful for a supplier to require a dealer to charge "even dollar prices" (*i.e.*, one dollar or two dollars but not $1.50). *Great Clips, Inc. v. Levine*, 1991 WL 322975 (D.Minn. 1991) Another case held that it is not *per se* unlawful to require a dealer to charge the same price as a certain other dealer, whatever that price might be. *Ben Elfman & Son. Inc. v. Criterion Mills, Inc.*, 774 F.Supp. 683 (D.Mass. 1991).

Price Assistance Programs With Price Floors. More complicated was the situation in which a supplier offered a discount to a dealer on the condition that the dealer pass the discount along to its customers, *but not reduce its resale price below a minimum price floor set by the supplier.* Suppliers in these situations believed that if they provided discounts to their dealers in order to support reductions in resale prices down to the level being charged for competing brands (so-called "wholesale price support"), they should be permitted to prevent a dealer from using the additional margin to wage a price war against other dealers by lowering its resale prices even more. This practice was held to be *per se* unlawful resale price maintenance in *Lehrman v. Gulf Oil Corp.*, 464 F.2d 26 (5th Cir.), *cert. denied*, 409 U.S. 1077 (1972), a holding that was followed recently by the Federal Trade Commission in *American Cyanamid*, Agreement Containing Consent Order to Cease and Desist, File No. 9510106 (1997).

Significantly, the court in *Lehrman*, in an opinion written by Judge Wisdom, recognized that there is a major distinction between minimum and maximum resale price maintenance, observing that although a supplier has no right to condition wholesale price support upon adherence to a specified *minimum* price, "[t]he supplier has a legitimate interest in satisfying himself that . . . retailers of the supplier's own product are charging no *more* than the price they have represented as requiring wholesale price support." *Id.* at 40 (emphasis added). Thus, the *per se* rule against minimum resale price maintenance in the context of price assistance

programs should not govern the analysis of maximum resale price maintenance in the context of price assistance programs.

Price Assistance Programs With Price Ceilings. In 1990, in *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990), this Court addressed a price assistance program that included *maximum* resale price maintenance, but because that case was brought by a competitor of the dealer who was subject to the price ceiling, it was decided on the ground that the plaintiff had suffered no antitrust injury. The Court explicitly declined to reach the issue of whether to retain the *per se* rule against maximum resale price maintenance, stating, "[w]e assume, *arguendo,* that *Albrecht* correctly held that vertical, maximum price fixing is subject to the *per se* rule." *Id.* at 335 n.5 (emphasis added).

Finally, the court below decided the present case. It held that the dealer, Khan, had no choice but to accept the discount and charge no more than the price specified by the supplier, State Oil, since Khan had agreed to rebate any excess profit above the agreed cap. Further, the court held that this arrangement amounted to maximum resale price maintenance, and therefore was *per se* unlawful under *Albrecht.*

Thus, the issue presented in this case is whether an agreement between a supplier and a dealer requiring the dealer to resell at no more than a specified maximum resale price should be subject to the same rule of *per se* illegality as minimum resale price maintenance. This is the same issue that was distinguished by Judge Wisdom in *Lehrman*, faced by the First Circuit in *Caribe BMW,* and avoided by the many courts that found ways around *Albrecht* over the years.

Importantly, the issue is not whether maximum resale price maintenance *ever* can be anticompetitive, but whether it is so consistently anticompetitive that it warrants blanket condemnation under the rule of *per se* illegality. As this Court repeatedly has explained, *per se* treatment should be reserved to practices "which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Northern Pac. Ry. Co. v. United States,* 356 U.S. 1, 5 (1958). *See also, Sylvania,* 433 U.S. at 49-50; *Northwest Wholesale Stationers, Inc. v. Pacific Stationary and Printing Co.,* 472 U.S. 284, 289 (1985); *Jefferson Parish Hospital District No.2 v. Hyde*, 466 U.S. 2, 15-16 (1984).

As explained below, maximum resale price maintenance is not such a pernicious practice.

WHY THE PER SE RULE SHOULD BE DISCONTINUED

For the reasons articulated in the Association's 1986 Report, the Association believed, and continues to believe, that the *per se* rule against maximum resale price maintenance should be overturned, and that maximum resale price maintenance should be judged under the rule of reason. Maximum resale price maintenance generally has the effect of lowering prices to consumers, and in general has greater potential to strengthen interbrand competition than to diminish it. For example, maximum resale price maintenance can be essential to the successful introduction of new products, where dealers may be tempted to take advantage of the situation by charging inflated prices. Further, although maximum resale price maintenance does have the potential to inhibit non-price

competition at the dealer level, such impact can be effectively weighed in a rule of reason inquiry to determine whether, on balance, a particular arrangement is procompetitive or anticompetitive with respect to interbrand competition.[6]

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6 In *Sylvania*, this Court held that "[i]nterbrand competition . . . is the primary concern of antitrust law." 433 U.S. at 52 n. 19.

As stated in the Association's 1986 Report:

"The rule against resale price maintenance agreements under Section 1 of the Sherman Antitrust Act[7] dates to 1911,[8] and repeatedly has been reaffirmed by the Supreme Court.[9] We do not seek to weigh the arguments for and against this rule generally, but note that the reasoning behind it seems inapplicable to maximum prices in particular.

"In the context of fixing *minimum* resale prices, the fear typically is that dealers will combine to obtain higher prices or price ranges, and rely upon manufacturers to enforce such pricing against recalcitrant dealers.[10] Similarly, the power to maintain prices at the retail level may promote collusion or parallel conduct on the part of competing manufacturers.[11] These risks, however, do not normally apply where the

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7 15 U.S.C. § 1.

8 Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

9 *E.g.,* Monsanto Co. v. Spray-Rite Service Corp., 104 S.Ct. 1464 (1984).

10 Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Georgetown L.J. 1487 (1983).

11 *Compare* Nye, "Can Conduct Oriented Enforcement Inhibit Conscious Parallelism," 44 Antitrust L.J. 206 (1975).

agreement merely keeps resale prices *down*,[12] although other risks may arise.

"The principal risk of maximum resale price maintenance is that it may stifle the ability of dealers to compete on the basis of offering ancillary services for which they cannot charge separately. For example, if some dealers would choose to compete by offering innovative, specially-equipped showrooms, educational programs or personalized service, but are prevented from charging a high enough price to cover their added costs, this dimension of competition will not develop. Similarly, if some dealers would choose to serve outlying geographic areas if they could charge enough to recover their costs, this added element of competition also will fail to develop if dealers are forbidden from charging more than a set limit.

"The chief reasons advanced for adopting maximum resale price agreements have been to protect the image of the manufacturer against loss of reputation among consumers who resent 'scalping' by high price dealers,[13] or to forestall possible public sector intervention. Of course, if maximum prices deprive dealers of a sufficient margin to promote or service a

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12 *See* American Bar Ass'n Antitrust Section Monograph No. 2, Vertical Restrictions Limiting Intra-Brand Competition 29, 84-96 (1977).

13 *Compare* FTC, Guides Against Deceptive Pricing, Guide III at 4-5, 16 C.F.R. § 233.3; Baltimore Luggage Co. v. F.T.C., 296 F.2d 608 (4th Cir. 1961), *cert. denied*, 369 U.S. 860 (1962).

product adequately,[14] the manufacturer can be expected to lose customers. Thus, the marketplace itself is likely to assess and help deter such errors if they occur.

"Some individual dealers may lose business to competing dealers of the same or other brands under maximum resale price maintenance. This consequence may be good or bad or neither. If it is simply the result of the fact that competitor's prices remain lower than they otherwise would be, such loss of business is not the concern of the antitrust laws, which are directed to preservation of competition, not individual competitors.[15] On the other hand, if dealers lose business because they are prevented from initiating innovative sales techniques, or expanding the borders of competition, or finding special niches, this may become a concern of antitrust.

"In recommending that maximum resale price agreements no longer be characterized as illegal *per se*, we do not contemplate that they should become exempt from normal antitrust scrutiny under the 'rule of reason' or other *per se*

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14 Methods such as cooperative advertising, direct payment for service, or nonprice vertical restraints can be used in these connections. As stated by Prof. Milton Handler: "The central teaching of Sylvania is that the overall effect of a vertical restraint must be the enrichment of competition in the market as a whole." *Antitrust - 1978*, 78 Colum. L. Rev. 1370 (1978).

15 *See* Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1977).

rules.[16] Where these arrangements promote competition, or at least do not unreasonably restrain it, they should be upheld. If such arrangements are anticompetitive under specific circumstances, however, they should remain vulnerable. For example, if a large dealer demands that a manufacturer bar higher-priced dealers from reaching other areas or performing more service, this could indicate that an illegal boycott,[17] unreasonable restraint,[18] monopolization or attempt to monopolize[19] was involved.

* * *

"Since 1977 the Supreme Court has not hesitated to re-examine[20] or narrow[21] *per se* rules where their basis was no longer evident and where courts have paid them only lip-

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16 *See* Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1979).

17 *Compare* Oreck Corp. v. Whirlpool Corp., 579 F.2d 126 (2d Cir.) (en banc), *cert. denied*, 439 U.S. 946 (1978).

18 *Compare* United States v. Grinnell Corp., 384 U.S. 563 (1966).

19 *See, e.g.*, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

20 Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1978).

21 *See* Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc., 441 U.S. 1 (1978).

service. The Court has looked to the purpose[22] of such rules rather than woodenly applying the text of prior articulations. The *per se* treatment of maximum resale price fixing agreements is a candidate for such re-examination."

These comments remain equally true today, and the Association respectfully urges the Court to reverse the decision below and instruct the lower courts henceforth to apply the rule of reason to maximum resale price maintenance.

CONCLUSION

WHEREFORE, the Association respectfully urges the Court to grant the petition and vacate the decision of the court below.

Respectfully submitted,

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22 *Compare* United States v. Classic, 313 U.S. 299, 317-18 (1941).

APPENDIX

ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK

Committee on Antitrust & Trade Regulation

REPORT ON MAXIMUM RESALE PRICE FIXING AS A *PER SE* VIOLATION

Summary

For some time the courts have treated *maximum* resale price fixing agreements,[1] like minimum[2] and price-range[3] agreements, as illegal *per se*. We recommend reconsideration of this rule.

Discussion

The rule against resale price maintenance agreements under Section 1 of the Sherman Antitrust Act[4] dates to 1911,[5]

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1 Albrecht v. Herald Co., 390 U.S. 145 (1968); Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, 340 U.S. 211 (1951).

2 California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980).

3 United States v. Bausch & Lomb Optical Co., 321 U.S. 707 (1944); United States v. Parke, Davis & Co., 362 U.S. 29 (1960).

4 15 U.S.C. § 1.

5 Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

and repeatedly has been reaffirmed by the Supreme Court.[6] We do not seek to weigh the arguments for and against this rule generally, but note that the reasoning behind it seems inapplicable to maximum prices in particular.

In the context of fixing *minimum* resale prices, the fear typically is that dealers will combine to obtain higher prices or price ranges, and rely upon manufacturers to enforce such pricing against recalcitrant dealers.[7] Similarly, the power to maintain prices at the retail level may promote collusion or parallel conduct on the part of competing manufacturers.[8] These risks, however, do not normally apply where the agreement merely keeps resale prices *down*,[9] although other risks may arise.

The principal risk of maximum resale price maintenance is that it may stifle the ability of dealers to compete on the basis of offering ancillary services for which they cannot charge separately. For example, if some dealers would choose to

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6 *E.g.*, Monsanto Co. v. Spray-Rite Service Corp., 104 S. Ct. 1464 (1984).

7 Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Georgetown L.J. 1487 (1983).

8 *Compare* Nye, "Can Conduct Oriented Enforcement Inhibit Conscious Parallelism," 44 Antitrust L.J. 206 (1975).

9 *See* American Bar Ass'n Antitrust Section Monograph No. 2, Vertical Restrictions Limiting Intra-Brand Competition 29, 84-96 (1977).

compete by offering innovative, specially-equipped showrooms, educational programs or personalized service, but are prevented from charging a high enough price to cover their added costs, this dimension of competition will not develop. Similarly, if some dealers would choose to serve outlying geographic areas if they could charge enough to recover their costs, this added element of competition also will fail to develop if dealers are forbidden from charging more than a set limit.

The chief reasons advanced for adopting maximum resale price agreements have been to protect the image of the manufacturer against loss of reputation among consumers who resent "scalping" by high price dealers,[10] or to forestall possible public sector intervention. Of course, if maximum prices deprive dealers of a sufficient margin to promote or service a product adequately,[11] the manufacturer can be expected to lose customers. Thus, the marketplace itself is likely to assess and help deter such errors if they occur.

Some individual dealers may lose business to competing dealers of the same or other brands under maximum resale price

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10 *Compare* FTC, Guides Against Deceptive Pricing, Guide III at 4-5, 16 C.F.R. § 233.3; Baltimore Luggage Co. v. FTC, 296 F.2d 608 (4th Cir. 1961), *cert. denied*, 369 U.S. 860 (1962).

11 Methods such as cooperative advertising, direct payment for service, or nonprice vertical restraints can be used in these connections. As stated by Prof. Milton Handler: "The central teaching of Sylvania is that the overall effect of a vertical restraint must be the enrichment of competition in the market as a whole." *Antitrust - 1978*, 78 Colum. L. Rev. 1370 (1978).

maintenance. This consequence may be good or bad or neither. If it is simply the result of the fact that competitors' prices remain lower than they otherwise would be, such loss of business is not the concern of the antitrust laws, which are directed to preservation of competition, not individual competitors.[12] On the other hand, if dealers lose business because they are prevented from initiating innovative sales techniques, or expanding the borders of competition, or finding special niches, this may become a concern of antitrust.

In recommending that maximum resale price agreements no longer be characterized as illegal *per se*, we do not contemplate that they should become exempt from normal antitrust scrutiny under the "rule of reason" or other *per se* rules.[13] Where these arrangements promote competition, or at least do not unreasonably restrain it, they should be upheld. If such arrangements are anticompetitive under specific circumstances, however, they should remain vulnerable. For example, if a large dealer demands that a manufacturer bar higher-priced dealers from reaching other areas or performing more service, this could indicate that an illegal boycott,[14]

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12 *See* Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477 (1977).

13 *See* Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1978).

14 *Compare* Oreck Corp. v. Whirlpool Corp., 579 F.2d 126 (2d Cir.) (en banc), *cert. denied*, 439 U.S. 946 (1978).

unreasonable restraint,[15] monopolization or attempt to monopolize[16] was involved.

Perhaps the most revealing evidence of the irrationality of the present rule is the length to which courts have gone to avoid it. In recent years courts have been applying some fairly tortured analysis to remain within the *per se* standard, yet avoid imposing liability on suppliers who seek to maintain a cap on resale prices.

The Albrecht Doctrine in the Courts

To this day, some courts continue to apply the *per se* rule of *Albrecht*[17] unswervingly.[18] In a recent opinion by Judge

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15 *Compare* United States v. Grinnell Corp., 384 U.S. 563 (1966).

16 *See, e.g*, Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

17 Albrecht v. The Herald Co., 390 U.S. 145 (1968).

18 *See, e.g.*, Blanton v. Mobil Oil Corp., 721 F.2d 1207, 1211 (9th Cir. 1983), *cert. denied*, 105 S.Ct. 1874 (1985) (gasoline supplier coerced retailer into lowering retail price, held *per se* illegal); Arnott v. American Oil Co., 609 F.2d 873, 884-85 (8th Cir. 1979), *cert. denied*, 446 U.S. 918 (1980) (same); Bartleys Town and Country Shops, Inc. v. Dillingham Corp., 530 F. Supp. 499, 505-6 (D. Hawaii 1982) (shopping center lease requiring retailers to maintain high sales volume, the effect of which was to require retailers to keep price low, held *per se* illegal); Crown Central Petroleum

(continued...)

Posner,[19] however, the Seventh Circuit questioned whether the holding of *Albrecht* survived the Supreme Court's decision in *Sylvania*.[20] Key figures within the Justice Department and the FTC also have questioned the continuing viability of the *per se* rule.

According to Judge Posner, "[n]ow that assigning exclusive territories to dealers is lawful if reasonable, a manufacturer-imposed price ceiling intended to limit the power that exclusive territories give dealers to raise prices regardless of what other dealers in the manufacturer's product are charging may also be lawful in some cases."[21] In support of this position the court cited Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 Colum. L. Rev. 1, 16 n.59 (1978), and *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir. 1978), which held that as a result of *Sylvania*, *minimum* vertical price fixing was not *per se* illegal as a means of enforcing a system of exclusive

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18 (...continued)
Corp. v. Brice, 427 F. Supp. 638 (E.D. Va. 1977) (same facts as *Blanton*, *supra*, but motion for retrial granted as judgment was against the weight of the evidence).

19 Jack Walters & Sons Corp. v. Morton Bldg., Inc., 737 F.2d 698, 706-7 (7th Cir. 1984), *cert. denied*, 105 S.Ct. 432 (1984).

20 Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

21 737 F.2d at 706-07.

territories.[22] Regardless of whether *Eastern Scientific* would be followed on its facts, maximum vertical price fixing would seem to present virtually an *a fortiori* case, since it cannot increase costs to consumers.

Other courts have disagreed. In a footnote to *Yentsch v. Texaco, Inc.*,[23] for example, the court stated that "[w]e need not enter the debate over whether maximum resale price maintenance should be treated differently from minimum resale price maintenance, since both are presently considered illegal *per se*."[24] The court noted the Pitofsky article cited above, but pointed out that *Sylvania* contained a footnote of its own which confirmed that price restrictions remain *per se* unlawful.[25] Another court, faced with similar arguments, reprinted a section of another Seventh Circuit opinion delimiting "the role of the lower courts in relation to pronouncements from the Supreme

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22 *See also* Knutson v. Daily Review, Inc., 468 F. Supp. 226, 231-32 n.7 (N.D. Cal. 1979), *aff'd*, 664 F.2d 1120 (9th Cir. 1981) ("recent case law has called into question the continued application of *per se* analysis to this type of case," citing *Continental T.V.* and *Eastern Scientific*).

23 630 F.2d 46 (2d Cir. 1980) (oil company acted to maintain resale price of gasoline, held *per se* illegal).

24 *Id.* at 51 n.3.

25 *Id.*; *accord*, Suburban Beverages, Inc. v. Pabst Brewing Co., 462 F. Supp. 1301, 1306 (E.D. Wis. 1978) (same).

Court", and declined to follow Judge Posner's arguments, applying instead the *per se* rule.[26]

Although few courts seem prepared to bury the Supreme Court's holding in *Albrecht* outright, a number of courts have been willing to go to some lengths to restrict its availability. These courts have taken a variety of approaches.

A. Insufficient Coercion

Some courts have attempted to limit *Albrecht's* reach by strictly construing its requirement that the defendant must coercively maintain a maximum price.

In *Curry v. Steve's Franchise Co., Inc.*,[27] for example, verbal harassment to lower prices was followed by a representative of the franchisor actually coming to the plaintiff's store and physically changing the prices listed on the menu boards and on the cash register. Because the franchisor never actually threatened retaliation for failure to comply with the franchisor's prices, however, the court found insufficient coercion, and thus no liability.

In *Dunn v. Phoenix Newspapers, Inc.*,[28] a newspaper actively solicited subscribers—subscribers the distributors were obligated to serve—at its suggested retail price. It also contracted directly with other subscribers for payment of the suggested price directly to the newspaper, and this amount was then credited to the distributor's account. The court found that

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26 Shafer v. Bulk Petroleum Corp., 569 F. Supp. 621, 625 (E.D. Wis. 1983), *quoting* Vail v. Board of Education, 706 F.2d 1435 (7th Cir. 1983).

27 1985-2 Trade Cas. ¶ 66,877 (D. Mass. 1985).

28 735 F.2d 1184 (9th Cir. 1984).

because the plaintiff/distributor had not tried to ask the subscribers to pay an additional amount, there would be no liability.

Finally, in *Dart Industries, Inc. v. Plunkett Co.*,[29] the manufacturer ceased dealing with a retailer after "constantly" urging the retailer to lower its prices, specifically pressuring the retailer in one instance, and publishing a rebate list varying the rebate by the resale price. Nonetheless, the court found that the retailer "retained complete control over its pricing policies" and imposed no liability.[30]

B. Price Assistance Programs

Courts have also shown a willingness to interpret around *Albrecht's per se* rule in the case of price assistance programs. Under such programs a manufacturer gives a distributor a discount, provided that the discount is passed on to consumers. In a series of recent cases, price assistance programs consistently have been upheld against charges that

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29 704 F.2d 496 (10th Cir. 1983).

30 *Id.* at 498. *See also* Martindell v. News Group Publications, Inc., 621 F. Supp. 672, 678 (E.D.N.Y. 1985) (newspaper threatened its distributors with termination if they did not adhere to the suggested price, held not liable for maximum price fixing because the threats did not actually coerce compliance and because no distributors were terminated as a result of the threats).

they constitute maximum resale price fixing, despite the fact that price restrictions are plainly involved.[31]

Jack Walters, for example, justified a manufacturer-imposed price assistance program on the ground that the manufacturer had advertised the resale price to the public, and it had a right to ensure the effectiveness of its advertising. The court stated that as it was lawful for the manufacturer to advertise a retail price, "it should be lawful to take at least the minimum steps necessary to make that advertising beneficial."[32] The court further concluded that the defendant's efforts to maintain the advertised price—including "threatening the dealers with termination if they went above that price, offering if they did to sell directly to the public at the advertised price, and checking up on the dealers to see whether they were charging more,"[33] constituted "the minimum steps that [the

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31 *Jack Walters*, *supra*, 737 F.2d at 707-8; Lewis Service Center, Inc. v. Mack Trucks, Inc., 714 F.2d 842 (8th Cir. 1983), *cert. denied*, 104 S. Ct. 2678 (1984) (in which the Government filed a significant *amicus* brief, arguing that Mack's program was pro-competitive); AAA Liquors, Inc. v. Jos. E. Seagram & Sons, Inc., 705 F.2d 1203 (10th Cir. 1982), *cert. denied*, 461 U.S. 919 (1983); Bryant Heating & Air Conditioning v. Carrier Corp., 597 F. Supp. 1045 (S.D. Fla. 1984). *But see* Pearl Brewing Co. v. Anheuser-Busch, Inc., 339 F. Supp. 945 (S.D. Tex. 1972).

32 737 F.2d at 708.

33 *Id.* at 706.

manufacturer] had to take if its advertised price was to have any value, and they are therefore lawful."[34]

C. Injury and Damages

Some courts have attempted to restrict *Albrecht's* availability by placing limits on who can file suits challenging maximum vertical price restrictions. For example, the court in *Jack Walters* argued, and alternatively held, that because maximum vertical price restraints are procompetitive when combined with a system of exclusive territories, the plaintiff had not suffered any antitrust injury, as required by *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*[35] Accordingly, the plaintiff in *Jack Walters* was not permitted to challenge the defendant's conduct.[36] The court emphasized that the only possible result of the maximum price fixing would be that the plaintiff would be forced to compete with other dealers of similar products. It concluded that "Walters will not be heard to complain about having to meet lawful price competition, which antitrust law seeks to encourage, merely because the competition may have

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34 *Id.* at 708. *See also Martindell*, *supra*, 621 F. Supp. at 678 (withdrawal of dealer support programs held lawful where newspaper's advertisements of suggested retail price did not violate the antitrust laws, as "logic dictates that failure to furnish promotional support to endeavors which undermined that lawful advertising also did not violate the antitrust laws").

35 429 U.S. 477 (1977).

36 737 F.2d at 708-9.

been enabled by an antitrust violation."[37] The court suggested that maximum price fixing would only result in an antitrust injury if the price was fixed at a level below the plaintiff's costs.[38]

Another means by which courts have attempted to limit suits for maximum vertical price fixing is by limiting plaintiffs to nominal damages. In *Newberry v. Washington Post Co.*,[39] for example, a group of plaintiffs were awarded only nominal damages because they could not prove beyond "the sheerest speculation" that they would have raised prices had it not been for the defendant's coercion. In contrast, other plaintiffs who had actually raised their prices despite the threats were awarded full treble damages.[40]

In *Knutson v. Daily Review, Inc.*,[41] the Ninth Circuit took a different approach. It recognized "the nearly impossible burden of proving what each dealer would have done if he had

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37 *Id.* at 709.

38 *Id. See also Knutson, supra* (advocating but not adopting a similar position); The Consortium, Inc. v. Knoxville International Energy Exposition, 563 F. Supp. 56, 60 (E.D. Tenn. 1983) (distributor could only benefit from maximum price fixing agreement between his supplier and trademark licensor, and therefore was not injured and could not sue).

39 438 F. Supp. 470 (D.D.C. 1977).

40 *Id.* at 483.

41 548 F.2d 795 (9th Cir. 1976), *cert. denied*, 433 U.S. 910 (1977).

been free to make his own pricing decision,"[42] and instead created a presumption that without the restraints, the dealers would have acted to maximize profits. That presumption could be rebutted with proof that the dealers would have kept their prices below the point of profit maximization nonetheless.

On remand, the defendant successfully rebutted the presumption.[43] The court found that the plaintiff distributors of the defendant's newspaper would not have raised their prices had there been no coercion because they knew that if they had done so, the newspaper would have terminated their dealerships and converted to an employee-distribution system. Therefore, according to the court, the distributors lost no profits as a result of the defendant's illegal price restraint, and only nominal damages could be awarded.[44]

Plaintiffs can, of course, still sue to have a maximum price fixing scheme enjoined. However, courts have been unwilling to enjoin a manufacturer from dropping its independent distributors in favor of an employee-distribution system, despite charges of maximum price fixing. In *Auburn News Co., Inc. v. Providence Journal Co.*,[45] and *Hardin v.*

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42 *Id.* at 812.

43 Knutson v. Daily Review, Inc., 468 F. Supp. 226, 240 (N.D. Cal. 1979), *aff'd*, 664 F.2d 1120 (9th Cir. 1981).

44 *Id. Accord*, Northwest Publications, Inc. v. Crumb, 752 F.2d 473 (9th Cir. 1985) (same).

45 659 F.2d 273 (1st Cir. 1981), *cert. denied*, 455 U.S. 921 (1982).

Houston Chronicle Publishing Co.,[46] for example, dealer motions for preliminary injunctions to stop newspapers from refusing to deal with them were denied on the ground that treble damages would be a sufficient remedy.

Conclusion

Since 1977 the Supreme Court has not hesitated to re-examine[47] or narrow[48] *per se* rules where their basis was no longer evident and where courts have paid them only lip-service. The Court has looked to the purpose[49] of such rules rather than woodenly applying the text of prior articulations. The *per se* treatment of maximum resale price fixing agreements is a candidate for such re-examination.

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46 426 F. Supp. 1114 (S.D. Tex. 1977), *aff'd*, 572 F.2d 1106 (5th Cir. 1978).

47 Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1978).

48 *See* Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1978).

49 *Compare* United States v. Classic, 313 U.S. 299, 317-18 (1941).

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* Members of the Subcommittee that prepared this report.

** Concurs in the result only.

*** Professor First has prepared the attached dissent, in which Judge Wittner, Professor Cavanaugh, and Messrs. Schiller, Shimer and Stoll join.

DISSENTING STATEMENT OF HARRY FIRST

I would not advocate a judicial change in the current rule which holds that all vertical agreements to fix resale prices, whether those prices are "maximum" or "minimum" prices, are *per se* illegal. I do agree that there may be some maximum resale price agreements which a fullblown inquiry might find to be reasonable. The wisdom of a "no trial" rule in this area, however, does not depend only on such cases; but must take account of the overall benefit such a rule has on pricing behavior and competition in general.

It is my view that there are benefits to maintaining the *per se* rule even for maximum resale price agreements. First, as the Supreme Court said in *Albrecht v. Herald Co.*, 390 U.S. 145, 152 (1968), and reaffirmed in *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 347 (1982), "[c]ompetition, even in a single product, is not cast in a single mold." Competition involves price, quality, and service. I would prefer to trust the judgment of the distributor competing in the retail marketplace to determine the precise mix which consumers prefer. If the manufacturer is concerned about distributors exploiting the monopoly power which flows from assigned exclusive territories, the problem should be cured by looking at the extent of the territorial restraint rather than by permitting the imposition of an additional restraint. See *Albrecht*, 390 U.S. at 154.

Second, a major benefit from the *per se* rule for maximum resale price-fixing is the protection it gives to the general rule that all agreements on price are *per se* illegal. I am concerned that retreat from the rule in the area of maximum vertical price fixing, as attractive as that might be for a few isolated cases, will create problems in three areas:

1. **Distinguishing ceilings from floors:** Once this form of price fixing is placed in the rule of reason category, we will inevitably see more overt price-fixing agreements. Some will start out as legitimate price ceilings; but, after a while, sales consistently made at the ceiling look little different from sales made at the floor. This will increase the chances for the facilitation of horizontal price-fixing, as noted in the Majority report. Further, it will be in the interest of some manufacturers and retailers to disguise minimum price-fixing agreements as maximum price agreements. Perhaps not all these disguises will work, but we will inevitably find more of these agreements which will require sorting either by the enforcement agencies or the courts.

2. **Distinquishing price from non-price restraints:** There are certainly economic distinctions between maximum and minimum price-fixing, and the Majority report is careful to make this distinction clear. Nevertheless, one cannot ignore the fact that the competitive arguments made by manufacturers for maximum resale prices—the advance of interbrand competition—can similarly be made for minimum resale prices. As Justice White noted both in his concurrence in *Continental T.V., Inc. v. Sylvania*, 433 U.S. 36, 69-70 (1977), and in his opinion for the Court in *Albrecht*, see 390 U.S. at 151 n.7, there are plausible justifications for a manufacturer to

control intrabrand minimum resale prices as part of a competitive interbrand strategy, such behavior allegedly holding little risk to competition because the market stands ready to discipline the manufacturer that sets too high a price. Why not subject those claims to case-by-case analysis?

3. **Distinquishing maximum horizontal price-fixing from minimum horizontal price-fixing:** The attractiveness of deserting the *per se* rule for maximum price fixing is that it appears to keep prices down. Horizontal maximum price-fixing will be put forward on the same grounds. Admittedly, such an argument sounds implausible when coming from competitors, but those involved in the professions or in service industries might very well attempt to make such arguments. Should we then subject such cases to fullblown inquiry?

A response to each of the above concerns, and one advanced by the Majority report, is provided by the siren call of the rule of reason. One can say that the desertion of the *per se* rule merely subjects such agreements to a rule of reason inquiry, and does not make such agreements lawful. This offers little protection. It has always been difficult to prove agreements "unreasonable." It may be even more difficult today, given the current willingness to define markets broadly and to require a connection between the concerted practice and the ability to exercise market power.

The *per se* rule for price-fixing agreements has served our economy well. I would not desert it even to permit

maximum resale price-fixing. The courts maintain some ability to work around the prohibition on maximum price-fixing (by failing to find agreement, for example); as do manufacturers (by offering direct rebates to consumers, or imposing sales quotas). On balance, I do not think that the benefits of allowing a few more cases through will exceed the far more significant costs of cutting back at the core of our antitrust protections.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U. KHAN, ET AL.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

AMICUS CURIAE BRIEF SUBMITTED ON BEHALF OF THE NATIONAL AUTOMOBILE DEALERS ASSOCIATION IN SUPPORT OF THE RESPONDENTS

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QUESTIONS PRESENTED

This brief addresses only the second question presented in the petition for a writ of certiorari:

Whether vertical maximum price fixing agreements should continue to be *per se* illegal under §1 of the Sherman Act, 15 U.S.C. 1?

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INTEREST OF THE AMICUS CURIAE

The National Automobile Dealers Association ("NADA") is a nonprofit national trade association of franchised motor vehicle dealers. Its approximately 19,500 members are located in all 50 of the United States. NADA frequently represents its members before this Court and other tribunals on issues affecting the retail motor vehicle trade, including issues concerning the relationships between motor vehicle manufacturers, dealers and retail buyers. Pursuant to Sup. Ct. R. 37, consents of all parties to the filing of this brief have been filed with the Clerk of Court.

NADA members participate in an industry that is characterized by intense intrabrand and interbrand competition. Such competition is not based solely on price. It also is based on serv ce, including such factors as new vehicle inventories, demonstrators, sales information, quality and training of sales personnel, dealer-installed accessories, and convenience and quality of after market service for the vehicle. In order to compete for new vehicle sales, a dealer must offer more than a competitive price. Today's retail motor vehicle buyer demands a high level of service from the dealer both during and after the sale.

Different buyers place different values on price and various service factors. Some buyers are willing to pay little for service and want only the lowest price available. Other buyers are willing to pay more to ensure a high quality of service.

Vertical maximum price fixing agreements between motor vehicle manufacturers and their dealers threaten service competition among the dealers. Such agreements

have the potential of limiting the range of choices that buyers will have regarding combinations of price and service factors. They place decision-making regarding the combinations of price and service factors that can be offered in the hands of the manufacturer and diminish the ability of an individual buyer and dealer to decide upon the most desirable combination for that buyer.

Vertical maximum price fixing agreements also invite collusion among dealers to lobby the manufacturer to maintain the price ceiling at an artificially high level. They also risk creating a uniform price at the price ceiling in an industry that traditionally has been characterized by intense price competition.

The anticompetitive risks of vertical maximum price fixing agreements in the motor vehicle industry are not justified by a need to control the exploitation of market power by retail dealers. NADA agrees with the American Automobile Manufacturers Association ("AAMA") and the Association of International Automobile Manufacturers ("AIAM") when they state in their *amici curiae* brief that there is "intense interbrand competition" in the motor vehicle industry. (AAMA and AIAM Brief, at 2). This is evidenced by the fact that there are 21 different manufacturers, some of whom offer more than one make of vehicle, who are members of AAMA or AIAM. Competition at the retail level of the motor vehicle industry is even more intense because, in addition to many interbrand competitors, there is intrabrand competition among dealers of the same make in most relevant markets.

Because of the intense interbrand and intrabrand retail competition in the motor vehicle industry, very few, if any, dealers possess the market power necessary to charge prices higher than those that would be set in a competitive market. The interest of AAMA and AIAM in advocating overturning the long-established *per se* rule against vertical maximum price fixing agreements is not in the prevention of market power exploitation by their members' dealers. Instead, the manufacturers' interest is in allowing themselves to substitute their own judgment for the workings of the marketplace in determining the retail price for motor vehicles. However, manufacturer interference with the competitive process by setting retail price ceilings for motor vehicles continues to pose the same economic risks as have been found previously by the Court in holding maximum price fixing to be *per se* illegal under §1 of the Sherman Act.

NADA members do not want the Court to abandon the *per se* rule against all forms of "naked" price fixing agreements which has served their industry well. They are not convinced that their manufacturers are "smarter" than the marketplace when it comes to determining the appropriate combination of price and service that will attract buyers to their products. Manufacturers are controlled by humans who, while educated and well-meaning, are hardly infallible when it comes to understanding what the public wants. All members of the motor vehicle industry, and the consumer, will be best served if manufacturers remain constrained by the *per se* rule from interfering with market forces by imposing maximum price fixing agreements on their dealers.

INTRODUCTION AND SUMMARY OF ARGUMENT

Almost from the inception of the Sherman Act, the Court has found virtually every form of price fixing agreement to be a *per se* violation of §1 of the Act. The only exceptions have been for price fixing agreements that are ancillary to some procompetitive venture that could not function without the agreement. *See, e.g., Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 22 (1979). "Naked" price fixing agreements have always been considered so potentially anticompetitive as to justify *per se* treatment.

After over 40 years of experience with price fixing agreements, the Court in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221-22 (1940) stated that "[a]ny combination which tampers with price structures is engaged in an unlawful activity," whether the combination "raised, lowered, or stabilized prices," and that if a change in the *per se* rule of illegality with regard to price fixing agreements was to be made "it must be done by the Congress." Since *Socony-Vacuum*, Congress has not acted to eliminate or modify the *per se* rule against all forms of "naked" price fixing agreements, and the Court has continued to apply the *per se* rule to such agreements, including those that only fix maximum prices. The Court has determined that both horizontal and vertical maximum price fixing agreements pose the real risk of anticompetitive injury including interference with the market's ability to decide the price that customers are willing to pay for service in connection with the products they purchase, discouraging innovation, the movement from maximum to uniform prices and the facilitation of cartels at both manufacturer and retailer

levels. *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 348 (1982); *Albrecht v. The Herald Co.*, 390 U.S. 145, 152-53 (1968).

Even if the Court is prepared to retreat now from its position in *Socony-Vacuum* that any change to the *per se* rule against any combination that tampers with price must be done, if at all, by Congress, the Court should not "lightly assume that the economic realities underlying" its decisions regarding the anticompetitive potential of maximum price fixing in *Maricopa* and *Albrecht* "have changed, or that earlier judicial perceptions of those realities were in error." *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 732 (1988). Any departure from the long-established *per se* rule against "naked" price fixing agreements, including vertical agreements that fix maximum prices, should require clear proof that the economic assumptions that gave rise to the rule in the first place were erroneous and that modification of the rule is required to avoid harm to competition.

Such proof does not exist. The potential anticompetitive harm of maximum price fixing agreements is as real today as it was when *Albrecht* and *Maricopa* were decided. The procompetitive arguments advanced by advocates for a modification of the *per se* rule with regard to vertical maximum price fixing agreements are without factual support. The only procompetitive argument in favor of vertical maximum price fixing agreements is the avoidance of market power exploitation by retailers. However, as the Court has recognized, "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers, . . ., and it should therefore not be assumed but rather must be proved."

Business Electronics Corp., 485 U.S. at 727, n.2 (citing *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54 (1977)). Given the absence of any real procompetitive justification for vertical maximum price fixing agreements, and their real potential for anticompetitive harm through artificial interference with the competitive marketplace, such agreements should continue to be governed by the *per se* rule of illegality.

ARGUMENT

I.

ALL FORMS OF "NAKED" PRICE FIXING AGREEMENTS HAVE ALWAYS BEEN ADJUDGED *PER SE* ILLEGAL UNDER §1 OF THE SHERMAN ACT

The *per se* rule against price fixing agreements was adopted by the Court in the first price fixing case arising under the Sherman Act. In *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897), "the Court was required to pass on the sufficiency of the defendants' plea that they had established rates that were actually beneficial to consumers. Assuming the factual validity of the plea, the Court rejected the defense as a matter of law." *Maricopa*, 457 U.S. at 350, n.22.

Forty-three years later in *Socony-Vacuum*, the Court observed:

> [F]or over forty years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful per se under the Sherman Act and that no showing of so-called competitive abuses or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense.

. . . .

> Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference. Congress has not left with us the determination of whether or not particular price fixing schemes are wise or unwise, healthy or destructive. . . . If such a shift is to be made, it must be done by the Congress. Certainly Congress has not left us with any such choice.

. . . .

> Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal per se.

Socony-Vacuum, 310 U.S. at 218, 221, 222, 223.

Neither Congress nor the Court has seen fit to change the broad application of the *per se* rule to all forms of "naked" price fixing agreements since *Socony-Vacuum*.

The *per se* rule against price fixing agreements has been applied as consistently to vertical price fixing agreements as it has been to horizontal agreements. In *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), the Court found in the first vertical price fixing case presented to it that the practice was a violation of the Sherman Act, notwithstanding the supplier's

assertions regarding "the importance of a standard retail price" and allegations "that confusion and damage have resulted from sales at less than the prices fixed." *Id.* at 407. In doing so, the Court noted that vertical price fixing agreements affecting all of a supplier's dealers have the same effects as horizontal price fixing agreements among the dealers themselves which "are injurious to the public interest and void." *Id.* at 408. "[T]he complainant can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other." *Id.*

The *per se* rule against both vertical and horizontal price fixing has also been consistently extended to maximum, as well as to minimum, price fixing agreements. The Court has adhered to the principle enunciated in *Socony-Vacuum* that a combination that tampers with price should be condemned *per se* whether or not the members of the combination have market power and whether the combination "raised, lowered, or stabilized prices." *Socony-Vacuum*, 310 U.S. at 218. In *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons*, 340 U.S. 211, 213 (1951), a case involving elements of both horizontal and vertical price fixing, the Court held that an agreement among competitors to fix maximum resale prices of their products was a *per se* violation of the Sherman Act because "such agreements, no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment." The *per se* rule against maximum price fixing subsequently has been applied by the Court to both pure vertical maximum price fixing agreements, *see Albrecht*,

390 U.S. at 149, and pure horizontal maximum price fixing agreements, *see Maricopa*, 457 U.S. at 342.

In applying the *per se* rule to maximum price fixing agreements, the Court has not, as some have suggested, engaged in "formalistic line drawing" but has instead considered the "demonstrable economic effect" of such agreements as is appropriate in categorizing a practice as *per se* illegal. *Business Electronics Corp.*, 485 U.S. at 724 (quoted sources omitted). In both *Albrecht* and *Maricopa*, the Court gave sound economic reasons for not carving out an exception from the *per se* rule for maximum price fixing agreements. *Albrecht*, 390 U.S. at 152-53; *Maricopa*, 457 U.S. at 332. These economic reasons will be discussed in more detail below.

Even the dissent in *Maricopa* did not urge repeal of the *per se* rule against "naked" maximum price fixing agreements. It instead felt that the agreement in that particular case should have been given consideration under the Court's single exception from the *per se* rule for price fixing agreements established under *Broadcast Music*, 441 U.S. 1, which requires that "[b]efore characterizing an arrangement as a per se price fixing agreement meriting condemnation, a court should determine whether it is a "'naked restrain[t] of trade with no purpose except stifling of competition'" or "whether the procompetitive economies that the arrangement purportedly makes possible are substantial and realizable in the absence of such an agreement." *Maricopa*, 457 U.S. at 361-62 (Powell, J., dissenting). Thus, the Court was unanimous in *Maricopa* that maximum price fixing is *per se* illegal unless necessary to the achievement of procompetitive benefits "that otherwise are not attainable." *Id.* at 364

(Powell, J., dissenting). The maximum price fixing agreement at issue in this case has not been shown to belong to this category and, therefore, does not justify departure from the application of the *per se* rule.

The Court has not suggested since *Albrecht* and *Maricopa* that either of those cases were wrongly decided. The principle that vertical price fixing agreements are *per se* violations of §1 of the Sherman Act has been assumed since then on several occasions. *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984); *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341 (1987); *Business Electronics Corp.*, 485 U.S. at 724; *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990). Because the application of the *per se* rule to both vertical and horizontal price fixing agreements is firmly established, the Court's decisions regarding vertical price fixing since *Albrecht* have dealt with the issues of when or under what circumstances an illegal vertical price fixing agreement is formed, *Monsanto, supra*, and *Business Electronics Corp., supra*, and whether a competitor of the members of a vertical maximum price fixing arrangement can show "antitrust injury" for purposes of collecting treble damages under §4 of the Clayton Act, 15 U.S.C. §15. *Atlantic Richfield, supra*. The *per se* rule of illegality for "naked" price fixing agreements of all forms, once they are shown to exist, remains a cardinal principle of the Court's antitrust jurisprudence.

II.

THE LONG-ESTABLISHED *PER SE* RULE AGAINST "NAKED" PRICE FIXING AGREEMENTS SHOULD BE MODIFIED ONLY BY CONGRESS OR, AT THE VERY LEAST, ONLY ON A CLEAR SHOWING OF ERROR IN THE ECONOMIC ASSUMPTIONS THAT UNDERLIE THAT RULE

A. The Court Has Previously Held That Any Change In The Per Se Rule Against All Forms Of "Naked" Price Fixing Agreements Should Be Done By Congress.

In *Socony-Vacuum*, the Court stated:

> Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. The Act places all such schemes beyond the pale and protects that vital part of our economy against any degree of interference. *Congress has not left with us the determination of whether or not particular price-fixing schemes are wise or unwise, healthy or destructive. . . . If such a shift is to be made, it must be done by the Congress.* Certainly Congress has not left us with any such choice.

Socony-Vacuum, 310 U.S. at 221-22 (emphasis supplied).

Because Congress has not seen fit to change the *per se* rule of illegality for any form of "naked" price fixing agreement since *Socony-Vacuum* was decided, the Court cannot now change the rule itself without violating its own proscription.

B. Even If Congress Does Not Have To Act To Change The Per Se Rule Against All Forms Of "Naked" Price Fixing Agreements, The Rule Should Not Be Modified Unless It Is Clear That The Economic Realities Underlying The Rule Have Changed Or That Earlier Judicial Perceptions Of Those Realities Were In Error.

In *Business Electronics Corp.*, the Court observed that "the common law, both in general and as embodied in the Sherman Act, does not lightly assume that the economic realities underlying earlier decisions have changed, or that earlier judicial perceptions of those realities were in error." *Id.* at 732. Accordingly, the Court should not depart from the long-established *per se* rule of illegality for all forms of "naked" price fixing agreements without clear proof that the economic assumptions on which the rule was established are no longer credible. Such proof is not present, as shown in the next section of this brief.

III.

THE ECONOMIC JUSTIFICATION FOR THE *PER SE* RULE AGAINST ALL "NAKED" PRICE FIXING AGREEMENTS, INCLUDING VERTICAL MAXIMUM PRICE FIXING AGREEMENTS, REMAINS SOUND

A. There Are No Perceivable Economic Differences Between The Effects Of Horizontal And Vertical Maximum Price Fixing Agreements.

Abolishing the *per se* rule of illegality for vertical maximum price fixing agreements would, at the very least, bring into question the *per se* rule against horizontal maximum price fixing agreements adopted by the Court in *Kiefer-Stewart*, *supra*, and *Maricopa*, *supra*. The economic reasons for applying the *per se* rule to horizontal

maximum price fixing agreements parallel those used by the Court to apply the same rule to vertical maximum price fixing agreements. There is no economic argument for applying the *per se* rule to one and not to the other type of maximum price fixing agreement.

In *Maricopa*, the Court stated that a horizontal maximum price fixing agreement violated the *per se* rule because it "tends to provide the same economic rewards to all practitioners regardless of their skill, their experience, their training, or their willingness to employ innovative and difficult procedures in individual cases," "discourage[s] entry into the market and may deter experimentation and new developments by individual entrepreneurs" and "may be a masquerade for an agreement to fix uniform prices, or it may in the future take on that character." *Maricopa*, 457 U.S. at 348.

In *Albrecht*, the Court gave the following reasons for making vertical maximum price fixing agreements *per se* illegal.

> [S]chemes to fix maximum prices, by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market. . . . Maximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which consumers desire and for which they are willing to pay. Maximum price fixing may channel distribution through a few large or specifically advantaged dealers who otherwise would be subject to significant nonprice competition. Moreover, if the actual price charged under a maximum price scheme is nearly always the

> fixed maximum price, which is increasingly likely as the maximum price approaches the actual cost of the dealer, the scheme tends to acquire all the attributes of an arrangement fixing minimum prices.

Albrecht, 390 U.S. at 152-53.

A comparison of the economic considerations given in *Maricopa* and *Albrecht* shows that the *per se* rule against maximum price fixing agreements has the same economic underpinnings with regard to both horizontal and vertical agreements. In summary, these economic underpinnings include: to ensure that market forces will decide the price that customers are willing to pay for product quality and services in connection with the product; to prevent the discouragement of innovation; to prevent potential uniform price setting when prices coalesce at the established maximum price; and to prevent facilitating cartels at either the manufacturer or retailer level.

The Court has observed that the "notion of equivalence between the scope of horizontal per se illegality and that of vertical per se illegality was explicitly rejected in *GTE Sylvania*, *see*, 433 U.S. at 57, n.27, . . ., as it had to be, since a horizontal agreement to divide territories is per se illegal, . . ., while *GTE Sylvania* held that a vertical agreement to do so is not." *Business Electronics Corp.*, 485 U.S. at 734. However, vertical territorial agreements were demonstrated in *GTE Sylvania* to have clear benefits to interbrand competition where, as shown below, vertical maximum price fixing agreements do not. Therefore, it would be very difficult for the Court to abolish the *per se* rule of illegality for vertical maximum price fixing agreements without also doing the same for horizontal maximum price fixing agreements, just as its holding that a competitor of vertical maximum price fixing arrangement does not have "antitrust injury" is equally applicable to competitors of a horizontal maximum price fixing arrangement.[1] *See*, *Atlantic Richfield*, 495 U.S. at 346 (Stevens, J., dissenting). To do so with regard to either type of an agreement would be a serious blow to the antitrust principles that have preserved competition based on innovation, service and other nonprice factors without artificial restrictions on the prices needed to cover the costs of such competition.

NADA does not intend to address all of the potential anticompetitive harms of vertical maximum price fixing agreements. Only the issues relating to injury to service competition, encouragement of horizontal collusion, potential harm to interbrand competition and potential for uniform price setting will be addressed in this brief.

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[1] Although NADA does not address the issue of "antitrust injury" in this brief, it does note that there is a substantial difference between the injury suffered, as a result of a vertical maximum price fixing agreement, by a competitor of the retailers who are parties to that agreement and the injury suffered as a result of that agreement by the retailers themselves or their customers. As the Court noted in *Atlantic Richfield*, the only injury suffered by the competitor may be the inability to charge higher prices. However, the retailers and their customers may be injured by the weakening of the retailers' abilities to engage in effective service and interbrand competition because the maximum price has been set too low. *Cf. Atlantic Richfield*, 495 U.S. at 345 (1990) ("A competitor will not bring suit to protect the dealer against a maximum price that is set too low, inasmuch as the competitor would benefit from such a situation.").

B. The Interference With Market Forces Caused By Vertical Maximum Price Fixing Agreements Is Harmful To Consumers Because It Limits Service Competition, Restricts Consumer Choice And Discourages Innovation.

Product purchase decisions are affected by factors other than price. In *GTE Sylvania*, 433 U.S. at 55, the Court noted that "[s]ervice and repair are vital for many products, such as automobiles and major household appliances" and that "[t]he availability and quality of such services affect a manufacturer's goodwill and the competitiveness of his product." Competition among retailers of a product with regard to service benefits consumers in a manner similar to price competition. In *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986), which found an agreement among dentists "to withhold from their customers a particular service that they desire" to violate even the rule of reason, the Court emphasized that the antitrust law is as much concerned with activities that restrain service competition as it is with restrictions on price competition.

> [N]o elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement. . . . A refusal to compete with respect to the package of services offered to customers, no less than a refusal to compete with respect to the price term of an agreement, impairs the ability of the market to advance social welfare by ensuring the provision of desired goods and services to consumers at a price approximating the marginal cost of providing them. Absent some countervailing procompetitive virtue—such as, for example, the creation of efficiencies in the operation of a market or the provision of goods or services . . . such an agreement limiting consumer choice by impeding the "ordinary give and take of the marketplace," . . . cannot be sustained under the Rule of Reason.

Id. at 459.

Because vertical maximum price fixing agreements also have the real potential of impairing service competition, with no "countervailing procompetitive virtue" to justify their existence except in very limited circumstances where they are necessary to prevent abuse of retailer market power, the continuation of the per se rule of illegality against such agreements is economically justified.

As recognized by the Court in both *Albrecht* and *Maricopa*, maximum price fixing agreements have the potential for restricting service competition by fixing prices too low to enable sellers to provide consumers with the level of service for which consumers, or at least some of them, are willing to pay. This may be done intentionally (such as where a group of sellers hope to avoid potentially costly service competition by agreeing on a price ceiling that will not allow more than a certain level of service) or unintentionally (such as where a manufacturer misjudges the level of service which potential users of its products desire and for which they are willing to pay). Whether the interference is intentional or unintentional, it harms consumers by reducing service competition and the choices of price and service combinations available to consumers.

Manufacturers normally impose a minimum level of service on their retailers,[2] but retailers often compete for product sales by offering service above that level. In the motor vehicle industry, service competition may include various items such as expanded service hours, free use of a vehicle while the customer's own vehicle is being serviced, off-site pickup and delivery of vehicles requiring service, emergency road and towing service and parts inventories, special tools and diagnostic equipment and technician training that exceed the manufacturer's requirements. Service competition is not limited to aftermarket service. Service competition also involves the selling process with regard to such factors as the number of demonstrators available for prospective purchasers to test-drive, the number of new vehicles held in inventory for immediate delivery to customers, the hours during which sales offices are open and the training of sales personnel. Retail service competition may also exist with

[2] In the motor vehicle industry, the minimum dealer service requirements that manufacturers impose are by themselves very costly for the dealers. Even without manufacturer-imposed retail price ceilings, the "low prevailing margins for dealers in a highly competitive interbrand market" (AAMA and AIMA Brief, at 15) leave little margin for dealers to invest in their own service innovations. Motor vehicle manufacturers already have a great disparity of bargaining power over their dealers. *New Motor Vehicle Board v. Orrin W. Fox Co.*, 439 U.S. 96, 100-02 (1978). Allowing manufacturers to define both the minimum service requirements and the maximum retail prices for their dealers would permit them to virtually eliminate all intrabrand service competition as well as to force dealers out of the market by denying them sufficient profits to cover the costs of the manufacturer-imposed service requirements.

regard to the dealer-installed accessories offered to consumers.

There is no credible evidence that manufacturers, even when acting independently, are better able to determine the combination of price and service desired by consumers than is established through direct negotiations between the consumers and dealers. Allowing manufacturers to fix maximum retail prices prevents retailers from responding appropriately to market signals that consumers place a value on a particular item of service or combination of services and are willing to pay more than the artificially imposed maximum price for the product with that service item or combination. Recent case, 110 Harv. L. Rev. 523, 526, n.34 (1996) ("[i]ndependent pricing in a competitive market improves market efficiency through more rapid communication of changes in value, and is thus an interest worthy of antitrust protection.").

Left to make the determinations for themselves, different retailers will reach different decisions regarding service levels desired by users of a product thus giving users several alternative combinations of service and price from which to select. Maximum price fixing interferes with the creation of these alternatives. Whether imposed by horizontal or vertical agreement, maximum price fixing forces each retailer who is a party to the agreement to provide no more than the level of service that the maximum price limit will allow.

The *per se* rule against vertical maximum price fixing ensures that the market will determine appropriate prices for the combinations of products and services that consumers want instead of the manufacturer setting arti-

ficial price limits that prevent some combinations from even being offered. Except in the unusual situation where a dealer possesses market power, a dealer will not be able to force consumers to accept a particular combination of product and service or to pay a supracompetitive price for the combination desired. If a dealer tries to do so, other dealers, usually both intrabrand and interbrand, will offer the consumer the desired combination at the lower market price.

Quoting Justice Holmes' dissent in *Dr. Miles*, 220 U.S. at 411 (Holmes, J., dissenting), the AAMA and AIAM brief argues that "'the most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear.'" (AAMA and AIAM Brief, at 9). This is precisely what the *per se* rule against vertical maximum price fixing does by preventing manufacturers from micro-managing their retailers' businesses in a way that interferes with the retailers' abilities to respond to market forces. As discussed below, there is no procompetitive justification for vertical maximum price fixing agreements that will justify allowing such interference with retailers' responses to market forces.

C. Vertical Maximum Price Fixing Agreements May Reduce Competition By Encouraging Horizontal Collusion.

In *Business Electronics Corp., supra*, the Court observed that "[c]artels are neither easy to form nor easy to maintain. Uncertainty over the terms of the cartel, particularly the prices to be charged in the future, obstructs both formation and adherence by making cheating easier." 485 U.S. at 727. An anticompetitive down-

side of vertical price agreements generally is that they may facilitate cartels at both the manufacturer or retailer level by making cheating more difficult for members of the cartel. *Id.* at 726.

Vertical maximum price fixing agreements, as well as minimum agreements, may have this facilitating effect. Retailers who want to limit competition among themselves with regard to costly service items may find that the easiest enforcement mechanism for such a cartel is to persuade the manufacturer to impose a maximum retail price ceiling for sales of its products that will not enable any retailer to exceed a certain level of service quality. NADA is concerned with any doctrine that gives manufacturers unnecessary control over their dealers' output and pricing decisions because history has demonstrated that manufacturer control of such decisions tempts dealers to conspire with the manufacturer to exert that control to limit competition at the retail level. *See, e.g., United States v. General Motors Corp.*, 384 U.S. 327 (1966).

D. Vertical Maximum Price Fixing Agreements Have A Greater Potential Of Harming, Than They Do Of Increasing, Interbrand Competition.

In *GTE Sylvania*, the Court refused to extend *per se* illegality to vertical nonprice restraints because such restraints "had real potential to stimulate interbrand competition, 'the primary concern of antitrust law.'" *Business Electronics Corp.*, 485 U.S. at 724. Vertical nonprice restraints can stimulate interbrand competition by "induc[ing] competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown

to the consumer" and "induc[ing] retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of [manufacturers'] products." *GTE Sylvania*, 433 U.S. at 55.

Vertical maximum price fixing agreements do not have this potential for stimulating interbrand competition. Instead, they have the opposite effect. They have the potential of artificially curtailing retailers' abilities to obtain the true market price for their products and services. When this occurs, it limits the retailers' abilities to make the investment of capital and labor, to engage in promotional activities and to provide service and repair facilities that the Court has identified as important components of effective interbrand competition. Therefore, the justification for applying the "rule of reason," instead of the *per se* rule, to nonprice vertical restrictions, does not apply to vertical maximum price fixing agreements. On the contrary, the fact that interbrand competition is "the primary concern of antitrust law" is an important reason for continuing the *per se* rule of illegality for vertical maximum price fixing agreements.

E. Vertical Maximum Price Fixing Agreements Have The Potential For Creating Uniform Prices.

A prime example of how this could occur is illustrated by the AAMA and AIAM *amici curiae* brief supporting the Petitioner. At pages 22 and 23 of that brief, the motor vehicle manufacturers argue that the *per se* prohibition on maximum resale price maintenance hinders brand-wide price advertising. Their complaint is that the present rule requires that "at most a manufacturer can advertise a 'suggested price' that may be available only at 'participating dealers'" and that changing the present rule will allow them to advertise maximum prices with the assurance that no dealer will exceed those prices. They also then argue that doing away with the *per se* rule will allow motor vehicle manufacturers "to implement 'one-price' or 'no haggle' pricing . . ." that will prevent dealers from negotiating prices with customers.

Brand-wide price advertising of maximum prices by manufacturers, in combination with manufacturer imposed "one-price" programs, have the obvious potential of fixing uniform retail prices among intrabrand dealers at the maximum price level. Maximum price advertising will condition the public to accept such prices as the "no-haggle" price when they visit the dealers' showrooms. The potential for uniform intrabrand pricing in an industry presently characterized by intense interbrand and intrabrand price competition, which may result from a change in the current rule, is "at odds with the antitrust laws' traditional concern for consumer welfare and price competition." *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 221 (1993).

F. Vertical Maximum Price Fixing Agreements Are Seldom Justified By The Need To Prevent Retailers From Exploiting Market Power.

The "arguable justification" for vertical maximum price fixing agreements is "that they prevent retailers or wholesalers from reaping monopoly or supercompetitive profits." *Albrecht*, 390 U.S. at 159 (Harlan, J., dissenting). However, the ability of retailers to reap "monopoly or supercompetitive profits" in the absence of vertical maximum price limits exists only in the unusual cases

where they possess market power. The *per se* rule of illegality does not require perfection in its application. "As in every rule of general application, the match between the presumed and the actual is imperfect. For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that a full-blown inquiry might have proved to be reasonable." *Maricopa*, 457 U.S. at 344.

Moreover, in those few cases where retailer market power exists, there are less anticompetitive and more procompetitive means for dealing with abuses of that power than imposing vertical maximum prices. It will be an unusual case indeed where abuse of retailer market power can be curtailed only by a vertical maximum price fixing agreement. If the Court makes any change in the current law regarding vertical maximum price fixing agreements, such change should be limited to allowing an exception to the *per se* rule where the agreement is shown to be essential to curbing abuses of retailer market power, similar to the exception that exists now for horizontal price fixing agreements that are essential to the functioning of a procompetitive activity. *See Broadcast Music*, 441 U.S. at 23.

"Market power is the power 'to force a purchaser to do something that he would not do in a competitive market.' . . . It has been defined as 'the ability of a single seller to raise price and restrict output.' . . . The existence of such power ordinarily is inferred from the seller's possession of a predominant share of the market." *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 464 (1992). A retailer cannot reap monopoly or supracompetitive profits unless it possesses market power.

However, "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers, see *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54, 97 S. Ct. 2549, 2559-60, 53 L.Ed. 2d 568 (1977), and it should therefore not be assumed but rather must be proved." *Business Electronics Corp.*, 485 U.S. at 727, n.2. The Court in *Business Electronics Corp.* observed that, "so long as interbrand competition existed, that would provide a 'significant check' on any attempt to exploit intrabrand market power." *Id.* at 725. In relevant markets where interbrand competition exists, vertical maximum price fixing agreements cannot be justified on the basis that they are necessary to avoid the exploitation of market power by the manufacturers' dealers.

The fact that the AAMA and AIAM brief admits that there is "intense interbrand competition" in the motor vehicle industry makes any argument that vertical maximum price fixing agreements are necessary to avoid customers having to pay above-market prices in that industry ring hollow. Moreover, the expansion of market boundaries through new technology developments such as Internet marketing and selling makes the potential for retailers possessing market power even less today than it was when *Albrecht* was decided. *Cf.*, Jonathan B. Baker, *Identifying Horizontal Price Fixing In The Electronic Marketplace*, 65 Antitrust L.J. 41 (1996) ("[m]arketing and direct sales on the Internet may be the wave of the commercial future.").

If a retailer does have market power, it most often will be because the manufacturer itself possesses such power and has transferred such power to the retailer through vertical nonprice restrictions on intrabrand competition. A manufacturer legitimately concerned with the abuse of

retailer market power that it has created through vertical nonprice restrictions has the means to deal with that abuse other than by imposing maximum retail price limits. It may instead remove the restrictions on intrabrand competition which gave the retailer market power in the first instance. Such restrictions may in fact be illegal under the rule of reason pursuant to *GTE Sylvania*, by virtue of their having facilitated the abuse of market power.

Increasing intrabrand competition will almost always be a more procompetitive way of dealing with retail market power than creating an artificial retail price ceiling. All that a vertical maximum price fixing agreement does is prevent the retailer with market power from charging above the fixed maximum price. The retailer still retains market power and, therefore, has no incentive to price below the fixed price, even if it is above what the price would be in a competitive market. Mark E. Roszkowski, *Vertical Maximum Price Fixing: In Defense of Albrecht*, 23 Loy. U. Chi. L.J. 209, 225 (1992). Increasing intrabrand competition in markets where interbrand competition is not sufficient to prevent the exploitation of market power eliminates retailer market power and ensures that consumers will pay only competitive prices.

Manufacturers, therefore, seldom have a true procompetitive justification for imposing vertical maximum price agreements on their dealers. Their reasons for doing so are either competitively neutral or anticompetitive. Where the market is competitive, as usually will be the case, dealers are presumed to price the packages of goods and services that they offer at market prices. A manufacturer's attempt to force its dealers to charge below mar-

ket prices in an effort to maximize the manufacturer's own short-term sales and profits, at the potential expense of weakening service and interbrand competition by those dealers in the long term, is not a procompetitive justification for vertical maximum price agreements. It is axiomatic that the antitrust law is enacted to protect competition, not individual competitors. *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104, 116 (1986). The *per se* rule against vertical maximum price fixing agreements protects competition with regard to both service and price and should be retained.

CONCLUSION

Based on the foregoing reasons and authorities, NADA respectfully asks that the Court not overturn the *per se* rule of illegality against vertical maximum price fixing agreements.

Respectfully submitted,

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No. 96-871

In the

Supreme Court of the United States

October Term, 1996

STATE OIL COMPANY,

Petitioner,

v.

BARKAT U KHAN, and KHAN & ASSOCIATES,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF OF AMICI CURIAE MINNESOTA SERVICE STATION AND CONVENIENCE STORE ASSOCIATION; SOUTH CAROLINA SERVICE STATION DEALERS ASSOCIATION; PETROLEUM RETAILERS AND AUTO REPAIR ASSOCIATION; SERVICE STATION DEALERS OF ARIZONA; NORTH CAROLINA SERVICE STATION ASSOCIATION; WEST VIRGINIA GAS DEALERS & AUTO REPAIR ASSOCIATION; IOWA RETAIL GASOLINE & AUTOMOTIVE TRADES ASSOCIATION; SERVICE STATION DEALERS ASSOCIATION OF MICHIGAN; NESSARA (NEW ENGLAND SERVICE STATION AND AUTOMOTIVE REPAIR ASSOCIATION); NEW YORK STATE ASSOCIATION OF SERVICE STATIONS & REPAIR SHOPS, INC.; AND WISCONSIN AUTOMOTIVE TRADES ASSOCIATION IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether the Court should overturn the rule established in Albrecht v. Herald Co., 390 U.S. 145 (1968), which held that vertical maximum price fixing is a per se violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

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INTEREST OF AMICI CURIAE

The Amici Curiae,[1] non-profit trade associations, represent the interests of retail gasoline dealers in 14 states: Arizona, Iowa, Maine, Massachusetts, Michigan, Minnesota, New Hampshire, New York, North Carolina, Pennsylvania, South Carolina, Vermont, West Virginia and Wisconsin. The consent of the parties to the filing of this brief has been received, and has been submitted to the Court.

These trade associations represent over 4500 dealers in the various states. The total number of gasoline retail outlets declined from 207,416 outlets in 1993 to 190,246 in 1996 as "stringent environmental regulations. . . wiped out thousands of marginal, low-volume units." Market Facts, 88 Nat'l Petroleum News, mid-July, 1996, at 120. Nationwide, there were 34,939 retail gasoline dealers of the top 25 oil companies in 1993, and those oil companies directly operated an additional 9225 stations. Performance Profiles of Major Energy Producers 1993, Energy Info. Admin., Dept. of Energy, DOE/EIA - 0206(93) 35 (1995). Retail dealers operate both traditional service station and convenience store outlets, which are the most common gasoline station types.

The membership of the Amici include a category of dealers that fits precisely the Respondents' profile. Retail gasoline dealers have two major sources of supply. Dealers are supplied either directly by refiners under the refiner's trademark or by a wholesaler or jobber, usually pursuant to a refiner's trademark. See, Market Facts, supra, at 35-43.

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[1] Pursuant to Sup. Ct. R. 37.6 of this Court, no counsel for a party has authored this brief, in whole or in part. No person or entity, other than amici curiae, their members and its counsel have made monetary contribution to the preparation or submission of this brief.

The question on which this court has granted certiorari- whether supplier-dealer agreements limiting the dealer's maximum resale price are per se violations of the Sherman Act - is of vital importance to the continued independence and, in many cases, the viability of retail gasoline dealers.

This case demonstrates why the per se rule retains vitality, particularly for franchisees and other retailers in exclusive supply arrangements. Not only is the key indicia of a dealer's independence as a business person undermined by vertical pricing arrangements, which interfere with the ability of the market to establish the competitive price, but here a maximum pricing scheme also established a minimum price.

An explanation of gasoline retail marketing and franchising generally may be useful to this Court in considering these issues.

SUMMARY OF ARGUMENT

This Court has acted to protect the independence of retail gasoline dealers from the "evil of . . . retail price maintenance" even when "the complainant may be only one merchant." Simpson v. Union Oil Co., 377 U.S. 16, 21 (1964).

> The fact that, on failure to renew a lease, another dealer takes Simpson's place and renders the same service to the public is no more an answer here than it was in Poller v. Columbia Broadcasting System, 368 U.S. 464, 473. For Congress, not the oil distributor, is the arbiter of the public interest; and Congress has closely patrolled price fixing whether

> effected through resale price maintenance agreements or otherwise.

Id. at 17 (footnote omitted).

Since at least 1911, this Court has repeatedly held that a dealer's right to determine his own resale price is too sensitive and too important to the competitive process to be subject to interference by his supplier. As stated by this Court in Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 724 (1988), "vertical agreements on resale prices have been illegal per se since Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911)." See also, Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211, 213 (1951); United States v. Parke Davis & Co., 392 U.S. 29, 47 (1960); Simpson v. Union Oil Co., 377 U.S. 13, 18 (1964); Albrecht v. Harold Co., 390 U.S. 145 (1968); and Catalano, Inc. v. Target Sales, 446 U.S. 643 (1980).

There is no compelling reason for this Court to depart from the well established and much relied upon precedent that vertical price fixing agreements which set minimum or maximum resale prices are per se violations of Sec. 1 of the Sherman Act, (15 U.S.C. § 1). Vertical price fixing interferes with the ability of a retailer to respond competitively to his market, determine his profitable pricing strategy, and make pricing decisions in accordance with the dictates of the retail market forces.

Abandonment of the per se rule against maximum vertical price fixing will prove too alluring to suppliers. They will use their coercive power over existing franchisees and dealers, especially those who are constrained by exclusive dealing arrangements, to usurp the dealer's profit margin, and ultimately his investment in the retail business. The end result of changing the per se rule against vertical price fixing

will be distortions in both the wholesale and retail markets, as suppliers, insulating themselves from direct market forces, squeeze dealer margins by establishing maximum prices while raising dealer costs. With imperfect market knowledge, pricing decisions at retail by wholesale suppliers will be erroneous. However, rather than being punished by the market place for setting the retail price too low in relation to the cost of goods, the suppliers will be rewarded by the capture of the retailer's profit margin and eventually by the return of the franchise, itself, complete with the dealer's goodwill and invested capital.

Virtually all criticism of Albrecht stems from the hypothesis that a competitive benefit will flow from maximum resale price fixing if the retail dealer enjoys a monopoly. That scenario, however, almost never occurs. Retailing is by far the most atomistic and competitive level of production. Given that reality, there is no need to reverse Albrecht. The hypothetical fear of dealer market power, at most, would justify the recognition of an affirmative defense to the per se rule against maximum vertical price fixing. Thus, if a supplier could demonstrate that his dealer possesses retail monopoly power he could justify a maximum resale price. That situation, of course, is not even arguably involved in the current case.

Moving from a per se rule to a rule of reason for maximum resale price maintenance will dramatically impact retailers without sufficient bargaining or economic power to resist the demands of the supplier. Maximum resale prices will be imposed only by the most powerful suppliers on the least powerful retailers. This would not achieve a competitive price. Those retailers are already obligated to charge no more than the competitive price by the structure of the retail market. Instead, the supplier would be able to force the retail

price below the competitive level. This would result in more of the product being demanded than would occur in a competitive market and a concomitant misallocation of economic resources. The competitive market requires not the lowest price, but rather the price which results from the unfettered forces of supply and demand.

Given the long and unambiguous history of the per se rule against all forms of vertical price fixing, and the billions of dollars invested by franchisees in reliance upon their pricing independence, this Court should not depart from the doctrine of stare decisis and should affirm its holding in Albrecht.

ARGUMENT

I. OVERRULING ALBRECHT WILL UNDERMINE THE INVESTMENT OF BILLIONS OF DOLLARS BY FRANCHISEES

The franchising industry, which now accounts for more than one-third of all dollars spent on retail transactions,[2] was built on retailer pricing independence. Albrecht was decided in 1968. From 1970 to 1992 the number of franchised business locations grew from 396,000 to 558,000 locations. Annual franchise sales exploded from 120 billion dollars to 803 billion dollars during the same time period.[3] In order to achieve this growth franchisees invested billions of dollars of

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[2] Warren S. Grimes, When Do Franchisors Have Market Power? Antitrust Remedies for Franchisor Opportunism, 65 Antitrust L.J., Fall 1996, 105.

[3] Franchising in The Economy, U.S. Dep't. of Com., Int'l Franchise Ass'n, Washington, D.C., 1992, cited in John Case, The Wonderland Economy, Inc. Magazine, May 1995, 14, 19.

sunk capital in their franchises.[4] Respondent Khan's investment in his retail business is fairly typical. Khan's investment included a Seventy-Five Thousand Dollar ($75,000.00) origination fee to State Oil, a Twenty-Five Thousand Dollar ($25,000.00) going concern fee, and an expenditure in excess of One Hundred and Five Thousand Dollars ($105,000.00) for capital, equipment, prepaid rent and security deposit. The vast majority of these expenses are sunk costs which cannot be recaptured if Khan leaves the business.

Franchisees make investments in reliance upon the franchisor's marketing expertise, the value of its trademark and the quality of its business system. The franchisor's promotional advantages[5] induces franchisee to invest in the franchise. But all franchisees to date have done so with the knowledge and in reliance on the fact that they could set their own prices and adjust those prices - up or down - to reflect changes in their costs.

Khan, of course, was a relatively new entrant into franchising. Substantial numbers of franchisees, however, have on- going long term relationships with their franchisors. Those relationships are periodically renewed by the execution of new franchise agreements. The petroleum industry is particularly illustrative of this phenomenon. In 1978, Congress passed the Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801-2806. ("PMPA") explicitly to protect franchisees from arbitrary and discriminatory terminations or non-renewals. Under the PMPA, the franchise relationship is

[4] Grimes, supra, 106; How Much Does It Cost? Breakdown by Total Investment, Success Magazine, Nov. 1994, 84-5 lists investments in the Ernest & Young Ranking of the top 100 franchises by 4 categories: under $75,000 (31 franchises); $75,001 to $150,000 (34 franchises); $150,001 to $250,000 (20 franchises); and over $250,000 (15 franchises).

[5] Grimes, supra at 106, 123.

"evergreen" and reflects the expectation of franchisees that the relationship will be a continuing one. Termination or non-renewal is prohibited unless certain specified grounds are present under § 2802.[6] This protection reflects Congress' concern that terminations or short term contracts were being utilized by franchisors to implement coercive marketing practices. Slatky v. Amoco Oil Co., 830 F.2d 476 (3rd Cir. 1987) (en banc); H.R. Rep. No. 95-1661, at 14 (1977) and S. Rep. No. 95-731, at 17 (1978).

Congressional enactment of the PMPA recognized that petroleum retailers were subject to particularly powerful franchisor controls. Often the franchisee leases real property from the franchisor, the franchisor is the exclusive supplier of the trademark gasoline sold by the franchisee, and the franchisor controls the trademark or business identity under which the franchisee operates.[7] These three control mechanisms over the petroleum franchisee were all present in the relationship between Khan and State Oil.

The general franchising relationship was described recently by a commentator:

> In franchising the vertical relationship, often between a supplier and a retailer, is continuous and sometimes intense. The franchisee may gain the good will associated with the franchisor's trademark, standards for the quality and style of operation associated with the mark, and perhaps from training and advice provided by the franchisor. Still, the

[6] First time or "trial franchisees" under a one year agreement are treated separately under 15 U.S.C. § 2803. State law protections against termination or non-renewal are preempted by 15 U.S.C. § 2806(a).

[7] H.R. Rep. No. 95-1661, at 14, S. Rep. No. 95-731 at 17.

> capital and risk incentives for operation of individual outlets remain much like those of independently owned businesses. The franchisee risks its own capital to own and operate an outlet. But, unlike in an independently owned business, a franchisee generally relinquishes a great deal of control over the outlet and must share with the franchisor the revenue generated by the outlet. Many franchisees pay an up-front franchisee fee, continuing royalties based upon sales, and subject themselves to the franchisor's monitoring.

Grimes, supra, at 107.

The petroleum franchise relationship was described by the Eighth Circuit Court of Appeals in Roberts v. Amoco Oil Co., 740 F.2d 602, 604 (8th Cir. 1984):

> The petroleum marketing franchise relationship has a history of tension and problems. In 1971, a leading commentator in the area of franchise law observed:
>
> > In the Nation's second largest industry, the major oil firms have the gasoline station dealers in virtual bondage, hinged on the constant threat that their short-term contracts will not be renewed unless they submit to burdensome franchisor-imposed practices.. . . It is generally conceded that the gasoline station situation is almost hopeless and offers a prime example of the worst of abuses in franchising.

> Brown, Franchising-a Fiduciary Relationship, 49 Tex. L. Rev. 650, 655-657 (1971).
>
> The financial hardship imposed on franchisees by high minimum rent and "minimum gallonage" requirements, burdensome marketing requirements which benefit the franchisor but not the franchisee, and the ease of franchise termination have forced many franchisees out of business. See Comment, Retail Gasoline Franchise Terminations and Non-Renewals Under Title I of the Petroleum Marketing Practices Act, 1980 Duke L.J. 522, 524-525 (1980).

Id.. The disparity in power between supplier and dealer in the petroleum industry was recognized by this Court in Simpson, 377 U.S. 13, 20-21. See, also, Atlantic Refining Co. v. FTC, 381 U.S. 357, 368 (1965).

> Particularly in mature franchise industries, franchisors, if allowed by a "rule of reason" analysis to impose maximum resale prices while also determining the franchisee's cost of goods, will have a tremendous economic incentive to subject the franchisee to a price/cost squeeze. By lowering the resale price while raising the franchisee's cost of goods through the use of pre-existing exclusive dealing arrangements, the franchisors will be able to first usurp the franchisee's profit and eventually, through vertical integration, his investment.[8]

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[8] Continental T.V., Inc., eliminated the per se rule for non-price vertical restraints to avoid the "incentive for vertical integration into the distribution system, thereby eliminating . . . independent businessmen." Continental T.V., Inc. v. G.T.E. Sylvania, Inc., 433 U.S. at 57, n.26 (1977). Elimination of the per se rule for vertical price restraints would perversely risk the same vertical integration, reflecting the wisdom of Continental T.V., Inc.'s observation that per se price restrictions involve a "significantly different . . . analysis and policy." Id. at 51, n.18.

Viewed from the franchisee perspective, the abandonment of the per se rule would allows suppliers, particularly those with exclusive supply contracts, to exploit the existing arrangements to transfer wealth.[9] Suppliers would have a strong financial motive to fix maximum prices,[10] and then raise supply costs so as to capture dealer margins and make likely the franchisees' business failure. While franchisees are desired and valued by franchisors for their initial franchise fees, capital investment and risk taking, particularly as a franchisor enters a new market, the attractiveness decreases after the franchisee has successfully entered and developed a market for the franchisor's product. As familiarity breeds attempt between the debutante and her suitor, success by the franchisee breeds attempt by the franchisor to secure the dealer's profits and investment for itself. If maximum price fixing is allowed, franchisors will be issued a license to go gunning for their most successful dealers in their most mature markets. The golden opportunity

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Furthermore, in Continental T.V., Inc., the franchisee had agreed to the non-price restraint at the time he became a franchisee. Here, the franchisees invested in their retail businesses under the belief that they could control their own prices and that it would be per se unlawful for their franchisor to interfere with that right. See also, Grimes, supra, at 126.

[9] Robert Lande, Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged, 34 Hastings L.J., Sept. 1982, at 67.

[10] In Simpson v. Union Oil Co., this court noted "the critical importance of price control to money making by the large oligarchies of business." 377 U.S. at 22, n.9. Not surprisingly, the amici supporting the Petitioner do not include a jobber association of which State Oil is a class, because jobbers will be subjected to the same price controls by refiners if State Oil prevails, but amici supporting Petitioner do include large oligarchies of business from major segments of the economy.

to engage in a price/cost squeeze will prove too alluring for franchisors to resist.[11]

This case illustrates the anti-competitive market dislocations caused by vertical maximum price fixing. If the franchisor could not control the franchisee's resale price, it would have to face increased resale prices and declining demand for its products when it raised its wholesale price. The ability to effectuate the price squeeze, however, allows the franchisor to raise wholesale prices without suffering the retribution of a free market. Furthermore, pressure on the retailers profit margin may well force him to cease providing services which the customers demand and for which they are willing to pay. This was explicitly recognized as an anti-competitive consequence of maximum vertical price fixing by this Court in Atlantic Richfield Co. v. U.S.A. Petroleum Co., 495 U.S. 328, 335-36 (1990) ("Arco") and by the First Circuit Court of Appeals in Caribe BMW, Inc. v. Bayerische Motoren Werke Aktiengesellschaft, 19 F.3d 745, 753 (1st Cir. 1994) (Breyer, J.).[12]

For virtually this entire century, and explicitly for the last half century (see, Kiefer-Steward Co. and Albrecht), this Court has repeatedly prohibited any interference with pricing decisions, whether maximum, minimum, vertical or

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[11] The importance of the dealer's effort in franchising is described in Andrea Shepard, Contractual form, retail price and asset characteristics in gasoline retailing, 24 Rand J. Economics, No. 1, Spring 1993, 58, 58-61.

[12] Both Arco and Caribe BMW also recognized that maximum vertical price fixing was anti-competitive in that it could lead to minimum vertical price fixing and could lead to concentration in the retail market by forcing all but a few very large (and likely vertically integrated) retailers from the market. Arco, 495 U.S. at 336, 110 S.Ct. at 1890; Caribe BMW, 19 F.3d at 753. Those holdings contrast sharply with the Seventh Circuit opinion below which, contrary to law and logic, states that antitrust injury can never result from vertical maximum price fixing. 93 F.3d at 1364.

horizontal, by independent business people.[13] During these decades of judicial adherence to the per se rule prohibiting all forms of price fixing, Congress by its "positive inaction" has allowed that absolute prohibition to stand and "has clearly evinced a desire not to disapprove of [it] legislatively." Flood v. Kuhn, 407 U.S. 258, 283-84 (1972). As a result, this Court should apply the doctrine of stare decisis, as it did in Toolson v. New York Yankees, Inc., 346 U.S. 356 (1953) and Flood v. Kuhn, and reaffirm its holding in Albrecht.

In Toolson this Court reconsidered its 1922 decision in Federal Baseball Club v. National League, 259 U.S. 200 (1922) where it decided that the business of baseball was neither trade nor commerce, and therefore, not subject to the antitrust laws. This Court held that in the thirty years since Federal Baseball was decided that the "business [of baseball] has thus been left . . . to develop, on the understanding that it was not subject to existing antitrust legislation" 346 U.S. at 357. This Court further noted Congress was aware of the Federal Baseball decision but did not reverse it legislatively. Because it would have been unfair to those who relied on the decision in Federal Baseball, this Court applied the doctrine of stare decisis, and declined to overrule its earlier, although

[13] While Continental T.V., Inc., 433 U.S. at 57 n.26 (1977) is often cited for the proposition that this court abandoned the "freedom of traders" rationale for the antitrust laws, that reading is incorrect. Justice White's concurring opinion feared that the Court was abandoning its longstanding and well-established concern for "the autonomy of independent businessmen," established in United States v. Colgate & Co., 250 U.S. 300, 307 (1919), Kiefer - Steward Co. v. Joseph E. Seagram & Sons, Inc., 340 U.S. 211, 213 (1951), and Albrecht, 390 U.S. 145, 152 (1968). The majority opinion, while rejecting Ninth Circuit Judge Browning's dissent in Continental T.V., Inc., on the pure "social value" of the autonomy of independent businessmen, made clear it was not rejecting that standard when it impacts "price, quality, and quantity of goods and services." Continental T.V., Inc., 433 U.S. at 53, n.21. [emphasis added]

erroneous decision. Twenty years later, Flood v. Kuhn, pointed out that Toolson was based, in part, on a desire to avoid the "consequent retroactive effect" of overruling a precedent on which businessmen had relied and a preference, under those circumstances, that a prospective "remedy be provided by legislation rather than by court decree" 407 U.S. at 273-74.

Flood v. Kuhn held that baseball was clearly commerce and that Federal Baseball had "become an aberration" which was "unrealistic, inconsistent and illogical." 407 U.S. at 282. Nonetheless, this Court pointed out that "[Federal Baseball] is an aberration that has been with us now for half a century, one heretofore deemed fully entitled to the benefit of stare decisis" Id. at 282. As a result, this Court again re-affirmed Federal Baseball, even though it believed - just as Judge Posner below believed of Albrecht[14]- that it was incorrectly decided. In doing so, this Court stated:

> If there is any inconsistency or illogic in all of this, it is an inconsistency and illogic of longstanding that is to be remedied by the Congress and not by this Court. If we were to act otherwise, we would be withdrawing from the conclusion as to Congressional intent made in Toolson and from the concerns as to retrospectivity therein expressed.

407 U.S. at 284.

In the current case, even if one believes Albrecht was incorrectly decided (which it was not), it should be reaffirmed

[14] In the decision below Judge Posner states "Albrecht was unsound when decided, and is inconsistent with later decisions by the Supreme Court." Khan v. State Oil Co., 93 F.3d 1358, 1363 (7th Cir. 1996).

on the basis of stare decisis. Even more so than in Flood or Toolson, independent businessmen/franchisees have relied for half a century on the explicit holdings of this Court that it constituted a per se offence for a supplier to vertically fix a dealer's maximum resale price. See Kiefer-Steward (1951) and Albrecht (1968).

Because they believed they could not be subjected to a cost/price squeeze by their franchisor, franchisees have invested hundreds of billions of dollars in sunk costs which they will not be able to recover if the rules are retroactively changed by the over ruling of Albrecht. Even if the Court believes Albrecht was incorrectly decided, it should defer to a prospective legislative solution just as it did for less compelling reasons in Toolson and Flood v. Kuhn. See also, Payne v. Tennessee, 501 U.S. 808, 828 (1991) ("considerations in favor of stare decisis are at their acme in cases involving property and contract rights, where reliance interests are involved"); Hilton v. South Carolina Public Railways Comm'n, 502 U.S. 197, 202 (1991) ("Congress has had almost 30 years in which it could have corrected our decision and has not chosen to do so. We should accord weight to this continual acceptance of our earlier holding. Stare decisis has added force when the legislature, in the public sphere, and citizens, in the private realm, have acted in reliance on a previous decision . . .").

II. THE REALITIES OF FRANCHISING MANDATE A PER SE RULE ON MAXIMUM RESALE PRICE MAINTENANCE

An examination of exclusive supply franchise arrangements provides ample support for continuation of the per se rule against maximum vertical price fixing. Suppliers

in exclusive arrangements, if given the ability to set the maximum prices charged by their retailers, will be given effective power to control the minimum price as well. Thus, while establishing the "maximum" price, State Oil was also the exclusive supplier of Khan, and was thereby able to establish his acquisition cost of goods. Unless Khan was to sell below his acquisition cost, his pricing decision range was 0-3% of his purchase price.[15] In 1992 and 1993, the industry wide gross margin per gallon was 11.2¢ and 12.8¢, meaning Khan had to price at the maximum allowable margin of 3.25¢ to be at 30% of the average retail gross profit per gallon.[16] The result is the precise danger warned of in Albrecht.

> Moreover, if the actual price charged under a maximum price scheme is nearly always the fixed maximum price, which is increasingly likely as the maximum price approaches the actual cost of the dealer, the scheme tends to acquire all of the attributes of an arrangement fixing minimum prices.

Albrecht, 390 U.S. at 153 (footnote omitted). Compare Simpson, supra, 377 U.S. at 20-21, n.7. Thus, State Oil, in effect, was able to establish Khan's minimum, maximum and actual price.

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[15] Gasoline retail prices generally exceeded $1.00 per gallon during the relevant time period of 1992-3. Market Facts, 88 Nat'l Petroleum News, at 102 (1996).

[16] The Seventh Circuit noted that the receiver operating Khan's station, by disregarding the price ceiling with State Oil and realizing a margin on gasoline sales in excess of 3.25% per gallon, created the inference that if Khan had been able to raise his price above the suggested retail price, he would have had a higher income. Khan, 93 F.3d at 1365.

The experience in Khan v. State Oil demonstrates that if allowed to engage in maximum price fixing, suppliers will either intentionally run their franchisees out of business (and appropriate their capital) or will make erroneous pricing decisions due to a lack of market information. Specifically, Khan could not survive under the maximum pricing scheme imposed by State Oil which allowed Khan only a gross margin of 3.25 cents per gallon on each grade of gasoline. The receiver, however, with better information or less venal intent than the franchisor, was able to succeed by lowering the price on non-premium gasoline, and increasing the price and margin on premium gasoline, precisely the strategy Khan wished to employ. See, Petitioner's Brief, 7-8.

Another margin strategy often employed by gasoline stations is to offer a self-service price, a slightly higher mini-service price and a still higher full-service price. In each instance, the higher price reflects the level of service being provided. Indeed, to attract more customers, dealers often offer car washes or other services at reduced or no cost depending on the mode and quantity of gasoline purchased. Although consumers clearly demand and are willing to pay for these services by paying a slightly higher per gallon price, those services will no longer be available to consumers if the suppliers can impose maximum vertical prices and force down the retail price. See, Continental T.V., Inc., 433 U.S. 36, 55 ("Service and repair are vital for many products . . .).

The result is that the retailer is unable to react to his local market with a mix of competitive prices and services. Again, Albrecht is instructive:

> But schemes to fix maximum prices, by substituting the perhaps erroneous judgment of the seller for the forces of the competitive market, may severally intrude upon the ability of buyers to compete and survive in that market. Competition, even in a single product, is not cast in a single mold. Maximum prices may be fixed too low for the dealer to furnish services essential to the value of which goods have for the consumer or to furnish services and conveniences which consumers desire and for which they are willing to pay.

390 U.S. at 152-153. See also, Caribe BMW, 19 F.3d at 753 (maximum resale price fixing might prevent dealers from offering services which consumers demand).

Economic theory explains this anticompetitive result by observing that when pricing decisions are made by the supplier, who is more removed and isolated from the market forces, and has less information on the particular market and location, the supplier is unable to respond as quickly or as accurately to the market and establish a competitive price.

Maximum retail price fixing also insulates the wholesaler from the market consequences of erroneous wholesale pricing. Because the retailer is prevented from raising retail prices in response to an erroneous wholesale price increases, the supplier is insulated from a predictable drop in the demand for its product as a result of its wholesale pricing mistake. The market forces at the wholesale level are therefore distorted and erroneous prices and a misallocation of resources result at both the wholesale and retail level.[17]

In this context, the observation of this Court in Continental T.V., Inc. v. G.T.E. Sylvania, Inc. is particularly instructive:

[17] Grimes, supra, at 153.

> The per se illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy. . . . There are, however, significant differences that could easily justify different treatment. . . . [U]nlike non-price restrictions, '[r]esale price maintenance is not only designed to, but almost in variably does in fact, reduce price competition not only *among* sellers of the affected product, but quite as much *between* that product and competing brands.' 372 U.S., at 268. Professor Posner also recognized that 'industry-wide resale price maintenance might facilitate cartelizing.'

Id., 433 U.S. at 51, n.18 [citations omitted]

Ultimately the criticisms of Albrecht all return to a single source: the competitive benefit of having a supplier control the retail prices of a monopoly dealer.[18] The only real world example of this, however, is Albrecht itself, where a distributor had an exclusive territory in which to distribute a monopoly product. As infrequently as that scenario obtained in 1967, there is even less reason to fear monopoly power by a retailer today.[19] In the post-industrial economy and the information age, retailers with exclusive territories and monopoly power are virtually non-existent. Local merchants were long ago challenged by discount chains, who were in turn challenged by regional malls, specialty discount marketers [i.e. the "big box" stores], mail order catalogs, cable television marketers, and most recently Internet sales. As for petroleum retailing, it would be anomalous to find that a retailer had even a scintilla of monopoly or market power.

[18] Mark E. Roszkowski, Vertical Maximum Price Fixing: In Defense of Albrecht, 23 Loy. U. Chi. L.J. 209, 222 (1992).

[19] Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 727 n.2 (1988).

The argument advanced by amici supporting Petitioner, that suppliers need to set maximum prices in order to have uniform promotional prices is also without merit. If the promotional price makes economic sense, the supplier should be able to persuade retailers to use that promotional price. See, Moro v. Shell Oil Co., 91 F.3d 872 (7th Cir. 1996); Winn v. Edna Hibel Corp., 858 F.2d 1517 (11th Cir. 1988); and Hanson v. Shell Oil Co., 541 F.2d 1352, 1357 n.4 (9th Cir. 1976), cert. denied, 429 U.S. 1074 (1977). In any event, unless this Court is willing to discard the per se rule against minimum retail price maintenance, setting maximum prices will not assure uniformity in promotional prices unless the maximum price effectively becomes the minimum price. Albrecht, 390 U.S. at 152.

CONCLUSION

For 50 years Keifer-Steward and Albrecht established and upheld the per se rule prohibiting vertical maximum price fixing. Price fixing is at the core of the antitrust laws. The ability to establish a competitive price is both the essence of independent business judgment as well as critical to the freedom of traders. Sound economic arguments support the per se rule against vertical price fixing.[20]

Dealers and franchisees, like Khan and the Amici herein, have invested billions of dollars in their franchises, sunk costs that cannot be easily extracted. Those investments were made in reliance upon this Court's decision in Albrecht that traders

[20] Roszkowski, supra, at 223-239.

would remain free to establish the mix of prices and services that would allow them to operate competitively and profitably in the market. This Court must not knock the props out from under these retailers, for the result will surely be franchisor encroachment on their profits and ultimately their investments through vertical maximum price fixing. Franchisees must remain free to establish their own prices or they will lose their investments and their livelihoods.

In light of Congressional inaction, as well as investments made by dealers and franchisees in reliance on this Court's longstanding and clearly expressed doctrine, this Court should adhere to stare decisis and affirm the per se prohibition against vertical maximum price fixing announced in Albrecht.

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QUESTION PRESENTED

The Service Station Dealers of America will address the following question:

Whether the Court should overrule its holding in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), that vertical maximum price fixing is a *per se* violation of Section 1 of the Sherman Act, 15 U.S.C. § 1?

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INTEREST OF AMICUS CURIAE[1]

The Service Station Dealers of America ("SSDA") is a national nonprofit trade association which represents the interests of service station dealers located throughout the United States. SSDA was formed in 1948, and represents twenty-six state and regional affiliates which in turn represent over 10,000 independent service station dealers in over thirty states. Those independent dealers have a vital interest in the issue presented to this Court, which challenges their right to determine their own retail prices. All parties have consented to the filing of this brief.

STATEMENT

Respondent Khan leased a service station and convenience store from petitioner State Oil Company ("State Oil"), pursuant to the terms of a lease and supply agreement which required him to purchase from State Oil the branded Union 76 gasoline which he resold to the public. The parties' lease and supply agreement further provided that respondent would purchase gasoline from petitioner at "suggested" retail prices set by petitioner, minus a margin of 3.25 cents per gallon. Pet. App. 2a-3a, 25a.

Under the terms of the lease and supply agreement, if respondent charged more than petitioner's "suggested" retail price, he was required to rebate to petitioner the entire amount by which his price exceeded the "suggested" retail price. This

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[1] In compliance with Rule 37.6 of this Court, amicus curiae, the Service Station Dealers of America, states that no counsel for any party authored this brief in whole or in part, and that no party or entity other than this amicus curiae, its members or its counsel made a monetary contribution to the preparation or submission of this brief.

eliminated any incentive for respondent to increase his prices, because he would inevitably sell fewer gallons of gasoline at a static margin. The lease and supply agreement further provided that petitioner would not reduce its price to respondent if respondent reduced his retail prices. Hence, respondent bore the full brunt of any reduction in retail prices.

By setting a uniform margin on all grades of gasoline, the lease and supply agreement eliminated any incentive for respondent to engage in price competition by decreasing his price for one grade of gasoline, while increasing his price for any other grade. Respondent could not, for example, offset a decrease in the price of regular gasoline by increasing the price which he charged for premium grades.

Reversing the district court's decision, the court of appeals held that the lease and supply agreement imposed maximum price fixing in a manner which was *per se* illegal under this Court's decision in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). Petitioner now requests this Court to overrule the holding in *Albrecht*.

SUMMARY OF ARGUMENT

Over the past eight decades, this Court has condemned as *per se* illegal *all* price-fixing agreements, whether maximum or minimum, whether horizontal or vertical. In so doing, this Court has repeatedly quoted the teaching of *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940), that "a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*." *See, e.g., Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 347 (1982); *Catalano, Inc. v. Target Sales*, 446 U.S. 643, 647 (1980); *United States v. Parke Davis & Co.*, 362 U.S. 29, 47 (1960); *Kiefer-Stewart Co. v. Joseph E. Seagram*

& Sons, Inc., 340 U.S. 211, 213 (1951) (all quoting the holding in *Socony-Vacuum*). *See also Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 724 (1988) ("vertical agreements on resale prices have been illegal *per se* since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 31 S.Ct. 376, 55 L.Ed. 502 (1911)").

Albrecht v. Herald Co., 390 U.S. 145 (1968), typifies this line of authority which regards price as far too sensitive to allow manipulation through contract, combination or conspiracy. Writing for the Court, Justice White's key insight was that -

> substituting the perhaps erroneous judgment of a seller for the forces of the competitive market . . . may severely intrude upon the ability of buyers to compete and survive. . . . Maximum prices may be fixed too low for the dealer to furnish services essential to the value which goods have for the consumer or to furnish services and conveniences which customers desire and for which they are willing to pay.

Id. at 152-53. *See also Kiefer-Stewart*, 340 U.S. at 213 (the *per se* rule is applied to maximum price fixing agreements because "such agreements, no less than those to fix minimum prices, cripple the freedom of traders and thereby restrain their ability to sell in accordance with their own judgment").

Thirty years after *Albrecht* a more complete analysis can be provided to explain why maximum vertical price fixing threatens efficient capital allocation in the distribution of goods and services. At the heart of this analysis is a critical economic reality: *maximum resale price maintenance can occur only when a supplier has power over its dealers*. The dealers and franchisees most likely to be injured by this

behavior are, like consumers, the least powerful and most vulnerable players in the economic system. Protecting small business from oppressive wealth transfers remains a primary goal of antitrust law, particularly when that goal is consistent with efficient allocation of economic resources.[2]

Albrecht's holding is both sound and consistent with the unbroken line of authority condemning all forms of price fixing as illegal *per se*. That line of authority should neither be lightly eroded nor abandoned. "[A]ny departure from the doctrine of *stare decisis* demands special justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984). Further, "[c]onsiderations of *stare decisis* have special force in the area of statutory interpretation, for here, unlike in the context of constitutional interpretation, the legislative power is implicated, and Congress remains free to alter what we have done." *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989). Finally, *stare decisis* has "added force" where "citizens, the private realm, have acted in reliance on a previous decision, for in this instance overruling the decision would dislodge settled rights and expectations. . . ." *Hilton v. South Carolina Public Railways Comm'n*, 502 U.S. 197, 202 (1991).

All of these considerations apply here. Dealers in this industry, and franchisees in general, have sunk significant costs

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[2] Robert Lande, WEALTH TRANSFERS AS THE ORIGINAL AND PRIMARY CONCERN OF ANTITRUST: THE EFFICIENCY INTERPRETATION CHALLENGED, 34 Hastings L.J. 67 (1982). This Court, in making its assessment of the economic effects of non-price vertical restraints, has on two occasions since *Albrecht* acknowledged the importance of independent small entrepreneurs in downstream distribution. *Continental T.V. v. GTE Sylvania Inc.*, 433 U.S. 36, 57 n.26 (1977); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 725 n.10 (1988).

into their businesses with the expectation that they would remain free to make their own pricing decisions, and not be subject to "the raising, depressing, fixing, pegging, or stabilizing" of prices by distant franchisors having imperfect knowledge of local marketing conditions. Congress has never suggested that their expectations should be dimmed, or that the *per se* rule against price-fixing should be trimmed or qualified. Petitioner and its supporting amici have failed to make any real world showing to justify curtailment of "the freedom of traders . . . to sell in accordance with their own judgment." *Kiefer-Stewart*, 340 U.S. at 213.

In their effort to overrule *Albrecht*, petitioner and its supporting amici imagine a parade of horrors which appears to consist of but one float bearing a single strawman representing a dealer with monopoly power. We submit that this phenomenon appears to the real world with the same approximate frequency as the Hale-Bopp comet. As this Court recognized in *Sharp Electronics*:

> Retail market power is rare, because of the usual presence of interbrand competition and other dealers, *see Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 54, 97 S.Ct. 2549, 2559-60, 53 L.Ed. 2d 568 (1977), and it should therefore not be assumed, but rather must be proved.

487 U.S. at 727 n.2.

We submit that conjuring up a theoretical dealer-monopolist bogeyman does not justify the wholesale rejection of a well-established legislative interpretation which has stood, without congressional objection, for decades. This is particularly true where the proposed remedy would enable suppliers with market power to impose allocative inefficiencies on their dealers and the public, and would cripple the principle

of independent pricing which has been a hallmark of antitrust law for over 80 years. Further, the *per se* rule should not be abandoned here because the restraint at issue had the effect of fixing both maximum *and* minimum prices. Finally, if any modification to the *per se* rule is required, it should only be to permit the supplier an affirmative defense to demonstrate that it merely acted to counter the non-competitive prices of a truly monopolistic dealer.

LEGAL ARGUMENT

I. *ALBRECHT* IS CONSISTENT WITH ANTITRUST GOALS OF MAINTAINING EFFICIENT ALLOCATION AND AVOIDING OPPRESSIVE WEALTH TRANSFERS

Kiefer-Stewart Co. v. Joseph E. Seagrams & Sons, Inc., 340 U.S. 211 (1951), involved two affiliated distillers who fixed the maximum price at which distributors could resell their brands of liquor. The Seventh Circuit found for the distillers, holding that an agreement "to fix maximum resale prices did not violate the Sherman Act because such prices promoted rather than restrained competition." *Id.* at 212. Reversing, this Court "reaffirm[ed] what we said" in *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940)

> Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*.

Id. at 213 (*quoting Socony-Vacuum*, 310 U.S. at 223).

This Court did not deem itself to be creating new law in *Albrecht*, when it applied *Kiefer-Stewart* in a purely vertical

context. It viewed itself as simply applying "the long-accepted rule in § 1 cases that resale price-fixing is a *per se* violation of the law whether done by agreement or combination." *Id.* at 151 (*citing United States v. Potteries Co.*, 273 U.S. 392 (1927); *Socony-Vacuum; Kiefer-Stewart; United States v. McKesson & Robbins, Inc.*, 351 U.S. 305 (1956)). The Court concluded:

> We think *Kiefer-Stewart* was correctly decided, and we adhere to it. Maximum and minimum price fixing may have different consequences in many situations. But schemes to fix maximum prices, by substituting the perhaps erroneous judgment of a seller for the forces of the competitive market, may severely intrude upon the ability of buyers to compete and survive in that market.

Id. at 152. *See also Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 347 (1982) ("We have not wavered in our enforcement of the *per se* rule against price fixing.").

Maximum vertical price fixing as condemned by *Albrecht* inevitably involves a supplier's exercise of power over its downstream dealers. As Judge Posner recognized below, a supplier without this power "cannot squeeze his dealers' margins below a competitive level; the attempt to do so would just drive the dealers into the arms of a competing supplier." 93 F.3d at 1362. Judge Posner reasoned, however, that even a supplier lacking market power might impose a maximum resale price as long as the dealer margin was set at a "competitive level." *Id.* at 1363. But this strategy would entail substantial risk for the supplier because dealers operating in diverse labor, real estate, regulatory and taxation settings have varying costs. To obtain a competitive return, each dealer must set a resale price that reflects these local market conditions. Unless a maximum retail price were set high enough to satisfy all dealers (in which case the price would be meaningless unless it were intended as a minimum

price), a supplier without market power would lose dealers who find the margin too low. In short, a supplier can effectively impose a maximum price only if it has power over its dealers.

This power to impose maximum prices reflects an inelastic demand for the supplier's offerings. The supplier has the power to squeeze the dealers' margins by raising its own prices while restricting the dealers' resale prices. This is an exercise of market power over downstream dealers, defined as "the power to raise prices without losing so much business that the price increase is unprofitable." *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370, 373 (7th Cir. 1986) (Posner, J.). *See also* William Landes and Richard Posner, MARKET POWER IN ANTITRUST CASES, 94 Harv.L.Rev. 937, 939 (1981).

That suppliers imposing maximum resale prices have power over downstream dealers may seem obvious, but theorists have been slow to focus on this point. Writing in defense of *Albrecht* in 1977, Professor Sullivan discussed the possibility of dealer exploitation, noting that if a dealer had made a specialized investment in plant or equipment, the dealer might be "locked into a situation where it cannot effectively resist such exploitation over the short or medium term." Lawrence Sullivan, HANDBOOK OF THE LAW OF ANTITRUST 391 (1977). But the insight that supplier power over dealers was a prerequisite for maximum resale price maintenance came more recently. Warren Grimes, WHEN DO FRANCHISORS HAVE MARKET POWER? ANTITRUST REMEDIES FOR FRANCHISOR OPPORTUNISM, 65 Antitrust L.J. 105, 152 (1996).

The supplier's power may be traced to the dealer's sunk costs, which consist of both franchise fees and investments in fixed assets and inventory which cannot be retrieved if the

supplier terminates the dealer. In this case, for example, Khan was required to pay State Oil $100,000 in non-refundable origination and going concern fees to obtain his station (J.A. 16). Such fees visit significant non-recoverable costs on the franchisee, thereby distorting the balance of power between franchisor and franchisee. Faced with a margin-squeezing maximum resale price imposed by the supplier, the dealer will likely swallow the loss of revenue rather than lose its substantial sunk investment. This problem of supplier power based upon sunk costs is acute for many franchises. Sunk costs are commonplace and substantial in franchising. Grimes, *supra*, at 125; Gillian Hadfield, PROBLEMATIC RELATIONS: FRANCHISING AND THE LAW OF INCOMPLETE CONTRACTS, 42 Stan.L.Rev. 927, 951-52 (1990).[3]

Sunk costs have become an accepted tool of antitrust analysis. In *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 476 (1992), this Court discussed sunk costs (described as "switching costs") as a determinant of market definition in a tie-in case and concluded that the plaintiff's theory involving single-brand monopoly power should survive summary judgment. *See also Allen-Myland, Inc. v. IBM*, 33 F.3d 194, 205 (3d Cir. 1994). As a result of several iterations of federal merger guidelines, sunk costs are an accepted part of market analysis in merger cases. U.S. DEPT. OF JUSTICE AND

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[3] Franchising is pervasive in late twentieth century distribution. Service stations, fast food outlets, soft drink bottlers, beer distributors and many other retail businesses are operated as franchise outlets. According to one source, more than one-third of the dollars spent on retail transactions flow through franchised outlets. 1995 FRANCHISE ANNUAL H5 (Lewiston, N.Y., Info. Press). The ability of a franchisee to price flexibly for local market conditions (subject to the constraints of interbrand and intrabrand competition) is central to earning a fair return on a franchise investment.

FTC HORIZONTAL MERGER GUIDELINES, § 1.32 (1992) (defining sunk costs and explaining their relevance in identifying firms which belong in the relevant market).

One commentator has described the antitrust injury which franchisees suffer from maximum retail price fixing:

> A maximum price imposed by the franchisor on the franchisee can be an opportunistic action in much the same way as a requirements tie or an inventory disposition tie. The franchisor can set its own price to ensure a high margin but limit the margin of its franchisees through a vertically imposed maximum price. The result is allocation distortions, both in terms of the investment dollars of the franchisee that were inefficiently allocated to a franchise and the distorted incentives created for the continued flow of goods and services supplied by the franchisor. For example, the franchisor can insulate itself from market forces that would dictate the phasing-out of an inefficiently produced product. In response to the price ceiling, the franchisee may attempt to raise its price on other goods to offset its reduced revenue on the price-fixed item. Or, in order to maintain its margin on the price-fixed item, the franchisee may cut back on ancillary services that the consumer would prefer to receive.

Grimes, *supra*, at 153.

Congress has expressed its concern with the problem of supplier power as it pertains to the petroleum industry. Gasoline suppliers enjoy enormous leverage over dealers like Khan because they are the dealers' landlords, licensors and exclusive suppliers. As both the House and Senate Reports

accompanying the passage of the Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801 *et seq.*, explain:

> The franchise relationship in the petroleum industry is unusual, in fact perhaps unique, in that the franchisor commonly not only grants a trademark license but often controls, and leases to the franchisee, the real estate premises used by the franchisee. In addition the franchisor almost always is the primary, even exclusive, supplier of the franchisee's principal sale item: motor fuel.
>
> Numerous allegations have been made before congressional committees investigating petroleum marketing problems that terminations and non-renewals, or threats of termination or non-renewal, have been used by franchisors to compel franchisees to comply with marketing policies of the franchisor.
>
> Essential to the problems faced by franchisees in this regard is the disparity of bargaining power which exists between the franchisor and the franchisee.

H.R. Rep. No. 1661, 95th Cong., 1st Sess., 14 (1977) and S.Rep. No. 731, 95th Cong., 2nd Sess., 17 (1978).

In *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964), this Court shared Congress' concern about this "disparity of bargaining power," and the resultant power of "franchisors to compel franchisees to comply with marketing strategies of the franchisor." Striking down a sham consignment device intended to fix the dealer's retail price, the Court said:

> Dealers, like Simpson, are independent businessmen; and they have all or most of the indicia of entrepreneurs, except for price fixing. The risk of loss of the gasoline is on them, apart from acts of God. . . .

> Practically the only power they have to be wholly independent businessmen, whose service depends on their own initiative and enterprise, is taken from them by the proviso that they must sell their gasoline at prices fixed by Union Oil. . . . The evil of this resale price maintenance program . . . is its inexorable potentiality for and even certainty in destroying competition in retail sales of gasoline by these nominal "consignees" who are in reality small struggling competitors seeking retail gas customers.

Id. at 20-21. *See also Atlantic Refining Co. v. FTC*, 381 U.S. 357, 368 (1965).

Here, as in most cases, maximum vertical price fixing is an allocation-distorting exercise of a supplier's power over a relatively powerless dealer. As such, it is properly condemned by an antitrust law designed to protect the consumers' interest in efficient allocation. As *Albrecht* concludes, the *per se* rule promotes full price and non-price competition at all distribution levels by prohibiting suppliers from substituting their "perhaps erroneous judgment . . . for the forces of the competitive market." 390 U.S. at 152. Khan suffered antitrust injury resulting from just such an erroneous judgment. Forced to follow State Oil's pricing dictates, his station was in receivership after a year.

II. THIS CASE EXEMPLIFIES HOW MAXIMUM PRICE FIXING ALSO ESTABLISHES MINIMUM PRICES

Albrecht identified a further evil of maximum price fixing which is present here. Such schemes "tends to acquire all the attributes of an arrangement fixing minimum prices." *Id.* at 153. *See also Maricopa County*, 457 U.S. at 348 (a maximum price fixing scheme "may be a masquerade for an agreement to fix uniform prices, or it may in the future take on that character").

A supplier lacking power over its dealers cannot impose resale maximum prices without risking the loss of high cost dealers. But by pushing the so-called "maximum" price to a level that satisfies all dealers, the supplier may impose a *de facto* minimum price under the guise of a "maximum price." Indeed, if this Court removes the *per se* rule for maximum price limits, a well-counseled defendant would be foolish not to invoke this classification defense.

As this Court recognized in *Albrecht* and *Maricopa County*, price fixing labeled as "maximum" may function as price fixing plain and simple, leaving the downstream dealer with no discretion to price either above or below the established price. In many cases, a fixed resale price may operate as a floor to some dealers and as a ceiling to others, presenting difficult classification problems for the court and involving protracted discovery and litigation over this issue.

State Oil's conduct in this case established both maximum and minimum prices. Petitioner's own brief explains how the dealer's minimum price was stabilized:

> The retailer was carrying three grades of gasoline. He claimed that if he had reduced the price of regular gasoline and increased the price of the two higher

> grades, he could both have sold more gasoline and earned more money. The increase in the price of the higher grades, plus the increased sale volume of the regular, would have more than covered the reduction in the price of the regular.

Id. at 7-8. In fact, the dealer could not reduce his price of regular gasoline because his margin was fixed on all grades of gasoline.

Discount dealers normally emphasize the pump price of their cheapest grade of gasoline, regular gasoline. State Oil, by directly fixing the maximum price for all of Khan's gasoline products, made it impossible for him to reduce the price of his most price sensitive grade. Competition suffered from State Oil's price interference because, as the receiver's subsequent experience demonstrates, the dealer's independent pricing strategy would have been well received in the marketplace. 93 F.3d at 1365. This is precisely the evil identified in *Albrecht* and *Maricopa County*.

III. NO JUSTIFICATION HAS BEEN PRESENTED FOR OVERRULING ESTABLISHED PRECEDENT WHICH HAS LONG BEEN RELIED UPON BY AMERICA'S RETAILERS AND ACCEPTED BY CONGRESS

This Court's interpretation of § 1 of the Sherman Act as condemning as illegal *per se* all contracts, combinations and conspiracies to fix prices is longstanding, and has never been challenged by Congress. "We have not wavered in our enforcement of the *per se* rule against price fixing." *Maricopa County*, 457 U.S. at 347. Given the importance of price competition in a free market system, this bright line rule appears to be fully justified. Indeed, petitioner and its

supporting amici have raised only the most theoretical objection to support a contrary result - the so-called dual monopoly paradigm.

"Virtually all criticism of the *Albrecht* rule is based upon the 'control of successive monopoly' economic paradigm." Mark Roszkowski, VERTICAL MAXIMUM PRICE FIXING: IN DEFENSE OF ALBRECHT, 23 Loy. U. Chi. L.J. 209, 228 (1992). But there is no reason to assume that the paradigm bears any significance in the real world. This Court has recognized that dealer market power is rare and should never be assumed:

> Retail market power is rare, because of the usual presence of interbrand competition and other dealers, *see Continental TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 54, 97 S.Ct. 2549, 2559-60, 53 L.Ed.2d 568 (1977), and it should therefore not be assumed, but rather must be proved.

Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 727 n.2 (1988).

No dealer power or dual monopoly has been demonstrated in this case. Khan was hardly a monopolist; his business failed after a year. Nor did his ultimate supplier, Union Oil, possess monopoly power. In 1995, only 380 of the 4,038 branded stations in Illinois - less than 10% - flew the Union 76 flag. MARKET FACTS, 88 National Petroleum News 44-52 (1996).

Nor do other service station dealers - or franchisees in general - possess anything like the monopoly power feared by *Albrecht*'s critics. There are numerous significant competitors in the petroleum industry, each of which supplies thousands of retail outlets. They include such potent competitors as Amoco, BP, Chevron, Citgo, Exxon, Getty, Mobil, Phillips, Shell, Texaco and Union Oil. Understandably, Congress is not concerned with non-existent "dealer monopoly power" in the

petroleum industry, but rather with the obvious inequity of bargaining power between franchisees and franchisors. Nor has it been suggested that any other segment of the franchise industry is anything but fiercely competitive

Even if monopoly dealers truly existed, no reason has been shown to justify the overruling of long established precedent. Suppliers already possess more than adequate tools to deal with any aberrant dealer monopolist. First, the monopolist dealer can only exist through an exclusive agreement given by the supplier itself. The supplier gave the monopoly and it can take the monopoly away. Second, the supplier can control the monopolist dealer's prices through the imposition of volume requirements. Third, suppliers regularly compete with their dealers through company-operated facilities. There simply is no need to add price fixing to the supplier's arsenal.

Nor do the decisions primarily relied upon by petitioner and its supporting amici, *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), and *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328 (1990), detract from the long line of authority holding that all price-fixing agreements are illegal *per se*. In *GTE Sylvania*, this Court stressed that it was concerned "only with nonprice vertical restrictions." 433 U.S. at 51 n.18. The Court continued, "The *per se* illegality of price restrictions has been established firmly for many years and involves significantly different questions of analysis and policy." *Id.*

One such significantly different question of analysis and policy involves the fostering of non-price competition. *GTE Sylvania* identified as a potential benefit of non-price vertical restraints the protection of exclusive dealers from "free riders," in order to permit them breathing space to provide additional services desired by consumers. *Id.* at 55. Conversely, *Albrecht* recognized that a detrimental effect of maximum vertical price-

fixing was that it discouraged dealers from engaging in just such non-price competition. 390 U.S. at 152-53. Another perceived benefit of vertical non-price restrictions is the use of exclusivity "to induce competent and aggressive retailers to make that kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer." 433 U.S. at 55. Maximum price maintenance confers no analogous benefit.

USA Petroleum involved only the question of whether a *competitor* of the parties to a vertical maximum price-fixing agreement could assert antitrust injury. After examining the anticompetitive aspects of maximum price-fixing identified in *Albrecht*, the Court concluded that a competitor would not suffer antitrust injury because "such an agreement [is] *per se* unlawful because of its potential effects on dealers and consumers, not because of its effect on *competitors*." 495 U.S. at 336 (emphasis in original). The Court then observed in *dictum* that "[t]he pro-competitive potential of a vertical maximum price restraint" had increased since *Albrecht* because exclusive territorial arrangements were no longer illegal *per se*, thus increasing the possibility of "monopolistic behavior by dealers" who possessed exclusive franchises. *Id.* at 343 n.13.

This concern is necessarily limited to the rare dealer capable of exhibiting "monopolistic behavior." Dealers lacking monopoly power necessarily would be driven to price at competitive levels. Even if this hypothetical monopolistic dealer posed an actual threat in the real world, there would be no need to overrule completely precedent which has shaped the face of American retailing for decades. All that would be required is to permit suppliers an affirmative defense to respond to excessive retail prices when a dealer monopoly truly exists. This Court's longstanding precedent should not be further eroded.

Allied-Signal, Inc. v. Directors Div. Of Taxation, 504 U.S. 768 (1992), considered the stringent test imposed on those who would overrule established precedent. In deciding whether to disturb existing law, "one relevant consideration is whether the decision is 'unsound in principle.'" *Id.* at 783 (*quoting Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528, 546 (1985)). Another consideration is whether established precedent is "unworkable in practice." *Id.* Additional considerations are the "reliance interest" of affected parties, and recognition that "[a]dherence to precedent promotes stability, predictability, and respect for judicial authority." *Id.* (*quoting Hilton v. South Carolina Public Railways Comm'n,* 502 U.S. 197, 202 (1991)).

Because "the doctrine of *stare decisis* is of fundamental importance to the rule of law," this Court has held that "any departure" from the doctrine "demands special justification." *Patterson v. McLean Credit Union*, 491 U.S. 164, 172 (1989) (*quoting Welch v. Texas Dept. of Highways and Public Transportation*, 483 U.S. 468, 494 (1987), and *Arizona v. Rumsey,* 467 U.S. 203, 212 (1984)). Moreover:

> [T]he burden borne by the party advocating the abandonment of an established precedent is greater where the Court is asked to overrule a point of statutory construction. Considerations of *stare decisis* have special force in the area of statutory interpretation, for here, unlike in the context of constitutional interpretation, the legislative power is implicated, and Congress remains free to alter what we have done.

Patterson, 491 U.S. at 172-73.

The petitioner and its supporting amici barely consider - much less satisfy - the considerable burden which they bear in

urging this Court to overrule longstanding precedent. They do not demonstrate that existing precedent is "unsound in principle," nor do they even suggest that it is "unworkable in practice." It is neither. The *per se* rule as presently interpreted by this Court promotes open price and non-price competition; preserves the competitive independence of individual traders; protects the public both from minimum price fixing agreements and from maximum price fixing agreements which tend to increase minimum prices; and protects all market participants from allocative injuries.

In addition, "[c]onsiderations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved." *Payne v. Tennessee*, 501 U.S. 808, 828 (1991). Dealers and franchisees throughout this nation have expended uncounted sums in sunk costs in reliance upon the promise, expressly made in this Court's precedents, that they indeed would be independent entrepreneurs able to control their own prices. Now, after their investments of money and time have been made, petitioner and its supporting amici blithely suggest that they be summarily deprived of what this Court has described as "[p]ractically the only power they have to be wholly independent businessmen," the power to control the price of the articles which they sell. *Simpson,* 377 U.S. at 20-21.

Finally, petitioner and its supporting amici ignore the significant fact that this Court's longstanding interpretation of the Sherman Act has never been questioned by Congress. This Court said in another context:

> Congress has had almost 30 years in which it could have corrected our decision . . . and has not chosen to do so. We should accord weight to this continued acceptance of our earlier holding. *Stare decisis* has added force when the legislature, in the public sphere,

> and citizens, in the private realm, have acted in reliance on a previous decision, for in this instance overruling the decision would dislodge settled rights and expectations or require an extensive legislative response. This is so in the case before us.

Hilton, 502 U.S. at 202. No basis has been shown to justify either overruling *Albrecht* or weakening the long established rule accepted by Congress that price fixing is illegal *per se*.

CONCLUSION

For the foregoing reasons, *Albrecht* should not be overruled.

Respectfully submitted,

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